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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1956.

NO. 754

WILLIAM G. LIAS, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

WILLIAM G. LIAS and ALICE B. LIAS, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

## PETITION OF WILLIAM G. LIAS AND ALICE B. LIAS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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*To the Honorable, the Chief Justice of the United States and The Associate Justices of the Supreme Court of the United States:*

The Petitioners, William G. Lias (referred to herein as "Petitioner Lias") and Alice B. Lias (referred to herein as "Petitioner Alice Lias") respectfully pray that a writ of certiorari issue to review judgments of the United States Court of Appeals for the Fourth Circuit affirming decisions of the Tax Court of the United States, which sustained deficiencies in federal income taxes and penalties, assessed by the Respondent, the Commissioner of Internal Revenue (referred to herein as "Respond-

ent") against Petitioner Lias for the years 1942 to 1947, inclusive, and against Petitioner Lias and Petitioner Alice Lias for the year 1948.*

## OPINIONS BELOW

The Opinion of the Tax Court of the United States is reported at 24 T.C. 280 and is included in the Petitioners' Appendix in the Court below at pages 1101a to 1169a. The Opinion of the Court below is reported at 235 F. (2d) 879 and a copy thereof is appended hereto.

## GROUNDS OF JURISDICTION

The judgments sought to be reviewed are judgments of the United States Court of Appeals for the Fourth Circuit, which were entered on August 3, 1956.

A petition for rehearing was filed within the prescribed period and was denied by the Court below, without opinion, on September 11, 1956.

On November 14, 1956, this Court made an order extending the time for filing this Petition to and including February 8, 1957. The Petitioners duly notified the Solicitor General of the United States of the extension.

The jurisdiction of this Court to entertain this Petition is based upon 28 U.S.C., § 1254(1).

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* Record references are to the Appendices filed by the Petitioners and the Respondent in the Court below, the Petitioners' Appendix being designated by the abbreviation "P.A." and the Respondent's by the abbreviation "R.A." In most instances, references are to the Tax Court's Opinion.

## THE QUESTIONS PRESENTED FOR REVIEW

1. May the Commissioner of Internal Revenue determine deficiencies in federal income tax against a taxpayer by using a consolidated net worth and expenditures formula under which the taxable income of the taxpayer is computed by subtracting from the aggregate amounts of consolidated net worth increases and consolidated expenditures of the taxpayer and several other persons the amounts of income reported for income tax purposes by the other persons?

2. Has the Commissioner of Internal Revenue sustained his burden of proof with respect to fraud where, in determining a taxpayer's taxable income by use of a consolidated net worth and expenditures formula, the Commissioner fails to prove (a) that the other members of the consolidated group correctly reported their taxable income and (b) that the other members had no cash on hand at the beginning of the taxable period, and where the only evidence of fraud is an inference arising from suostantial discrepancies between the amounts of taxable income as reported by the taxpayer and the amounts of taxable income as so determined by the Commissioner?

## THE STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U.S.C. 1952 ed., Sec. 22.)

* * * * * * *

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or

does not keep books, the net income shall be computed on the basis of the calendar year.
(26 U.S.C. 1952 ed., Sec. 41.)

* * * * * * *

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in Section 276—

(a) *General Rule.* — The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

(26 U.S.C. 1952 ed., Sec. 275.)

* * * * * * *

SEC. 276. SAME—EXCEPTIONS.

(a) *False Return or No Return.* — In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(26 U.S.C. 1952 ed., Sec. 276.)

* * * * * * *

SEC. 1112. BURDEN OF PROOF IN FRAUD CASES

In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof of such issue shall be upon the Commissioner.

(26 U.S.C. 1952 ed., Sec. 1112.)

* * * * * * *

## STATEMENT OF THE CASE

On December 20, 1949, the Respondent determined deficiencies in federal income taxes against Petitioner Lias for the years 1942 to 1946, inclusive, against Petitioner Lias for the year 1947 and against the Petitioner Lias and the Petitioner Alice Lias, wife of Petitioner Lias, for the year 1948, with respect to which Petitioners had filed a joint return. In addition, penalties for fraud with intent to evade tax (50%) were assessed with respect to all the taxable years and for substantial under-estimates of estimated tax (6%) with respect to all years except 1942 and 1948.

Petitions for redetermination of the deficiencies were duly filed with the Tax Court of the United States pursuant to § 272 of the Internal Revenue Code of 1939 (26 U.S.C. § 272) and were docketed at No. 27264 (involving the Petitioner Lias for the years 1942 and 1946, inclusive) and at No. 27762 (involving the Petitioner Lias for the year 1947 and both Petitioners for the year 1948). The proceedings were consolidated for hearing and decision in the Tax Court (See Tax Court Opinion, P.A. 1102a).

After an extended hearing (the transcript before the Tax Court covered approximately 7,150 pages), the Tax Court, on May 26, 1955, filed its Opinion, including findings of fact and conclusions of law, sustaining the Respondent's determination in every substantial respect (P.A. 1101a *et seq.*). Pursuant to this Opinion, decisions were entered, under Rule 50 of the Tax Court, on September 12, 1955, determining deficiencies and penalties against Petitioner Lias for the years 1942 to 1947, inclu-

sive, in the aggregate amount of $1,985,729.15, including 50% fraud penalties of $634,876.68 for all years and 6% under-estimate penalties of $81,974.13 for the years 1943 to 1947, inclusive, and against both Petitioners for the year 1948 in the amount of $26,493.03, including a fraud penalty of $8,831.01. Moreover, in addition to imposing fraud penalties, the Tax Court also held that the deficiencies for the years 1942, 1943 and 1944 were not barred by the three-year statute of limitations because the returns for such years were fraudulent (P.A. 1168a).

A brief review of the facts leading to the deficiency assessments and of the Respondent's method of determining the deficiencies may be in order. Except where otherwise indicated by reference to specific testimony, the facts are taken from the Tax Court's findings.

The Petitioner Lias, during the years 1942 to 1945, inclusive, was engaged in the business of gambling in the area of Wheeling, West Virginia, where he had his home (P.A. 1104a to 1108a). Throughout most of this period gambling, although unlawful, was openly permitted by the municipal authorities on an informal licensing basis (P.A. 1107a; 1166a; see testimony R.A. 1049 to 1055). The Petitioner Lias also engaged in other business endeavors (P.A. 1108a-1109a). His gambling activities were carried on through several partnerships and corporations in which others (relatives or outsiders) usually had some proprietary interest (P.A. 1105a to 1108a). The activities engaged in by these organizations were varied; there were gambling establishments, so-called "horse books" and slot machines (P.A. 1105a to 1107a). These partnerships and corporations kept

books and records and filed tax or information returns (P.A. 1119a-1120a; see testimony P.A. 21a to 26a).

The Petitioner Lias' federal tax returns for the years in issue were prepared by a Certified Public Accountant, a Mr. Goldberg (P.A. 1119a-1120a), who also had set up the accounting systems for most of the entities in which the Petitioner Lias was interested (see testimony P.A. 18a to 26a). The Tax Court found, contrary to the contentions of Petitioner Lias, that he did not keep permanent personal books of account; Mr. Goldberg prepared his returns (and those of Petitioner Alice Lias) from the books and records of the various partnerships and corporations in which Petitioner Lias was interested and from which he derived income, from Petitioners' bank books and checks and receipts and from information furnished by them (P.A. 1120a). The Petitioner Lias paid substantial amounts of federal income tax in all the years in issue; the Petitioner Alice Lias paid such taxes in all years except 1945 and 1947 (P.A. 1138a).

The Petitioner Lias was indicted, in the United States District Court for the Northern District of West Virginia, for wilfully and knowingly attempting to defeat and evade federal income taxes for five of the years in issue (1942 to 1946) and after a jury trial was acquitted on July 2, 1949 (P.A. 1141a).

In practically all of Petitioner Lias' business activities, gambling or otherwise, certain members of his family had interests of varying amounts. These were his wife, the Petitioner Alice Lias, his brother, John Lias, his brothers-in-law, Gregory and William Koutroumanos (also called "Manos" and so referred to herein),

his children, George B. and Antoinette Lias, and, to a minor extent, his mother-in-law, Mary Koutroumanos (Manos) (see P.A. 1104a and 1141a *et seq.*). The Petitioner Lias handled and invested all of the funds of the group as he "saw fit" (P.A. 1148a). The members of the group paid substantial amounts of federal income tax (P.A. 1144½a).

The crux of this case is the method used by the Respondent, with the approval of the Tax Court and the Court below, to determine the Petitioner Lias' taxable income. It is based on the device commonly known as the "net worth" or "net worth and expenditures" method, with this novel and significant extension, that, instead of using the Petitioner Lias' individual net worth increases and expenditures, the Respondent's calculations are made on a *consolidated* basis, using the changes in net worth and expenditures of the group *as a whole,* and the Petitioner Lias is charged with *all* the income resulting from the calculation except such as was reported (as adjusted) for federal income taxes by other members of the family group. (In using the term "adjusted", we do not mean to imply that the Revenue Agents made any adjustments based on the net worth calculation; the adjustments were minor technical items.)

The "key" witness for the Respondent on this point was Revenue Agent Harold E. Young who produced and explained the basic consolidated net worth schedules, which are in effect summarized in Schedules A and B to the Tax Court's Opinion (P.A. 1143a, 1144a and 1144½a). According to Mr. Young, he computed the

aggregate net worth of the entire group at the end of each year, beginning with the date December 31, 1941 and ending with December 31, 1948 (P.A. 881a to 885a); to increases in such net worth, he added the group's consolidated non-deductible expenditures for each year and from these results he subtracted non-taxable income to arrive at, for each year, what he termed "a corrected taxable income for the family as a whole" (P.A. 913a). According to his testimony, he made no effort to calculate individual net worth changes or expenditures (P.A. 974a) but treated all eight members of the family as a unit (P.A. 966a and 974a). From the consolidated net income figures thus computed, he then deducted the taxable income of each other member of the group (except for Mary Manos and the Petitioner Lias' children, who presumably had no such income) as reported or adjusted, leaving amounts which, he states, would be the "corrected net income" of Petitioner Lias for the years in issue (P.A. 913a and 914a).

This procedure the Tax Court has described as follows (P.A. 1149a):

> "The combined taxable net income of the petitioner, his wife, his brother, and brothers-in-law, was determined by taking the increase in their combined net worth during each year, adding federal income taxes, insurance premiums, and personal expenses paid during each year, and making proper adjustments for capital gains and losses. From such combined taxable net income there was deducted the income reported or adjusted for the other members of the family group, leaving the taxable net income of the petitioner."

The Tax Court, it should be noted, makes no reference to Mary Manos or the Petitioner Lias' children at this point although they were actually included in the computations, probably because the Court did not consider their contributions to net worth to be of any great significance.

Another aspect of Mr. Young's computations should be mentioned. In his opening net worth figures (at December 31, 1941), he gives no credit for cash on hand (P.A. 916a). With respect to the Petitioner Lias' own funds, this may be of no significance, because the Tax Court found, against his testimony and that of numerous other witnesses, that he had no cash on hand (P.A. 1122a). Mr. Young further testified, however, that he did not take into account any cash which other members of the group may have had on the opening date (P.A. 968a), he did not interrogate any of them as to their cash reserves (P.A. 916a-917a) and he did not know of any other agent connected with the investigation of Petitioner Lias who had made such an interrogation (R.A. 962).

As indicated, the Tax Court sustained the Respondent's determination of deficiencies based on the consolidated net worth method (P.A. 1150a), holding, in effect, that the Petitioner Lias had the burden of proving a proper allocation of consolidated net worth increases and expenditures. It also (a) sustained deficiencies as to the years 1942, 1943 and 1944, which otherwise would have been barred by the statute of limitations, on the ground that the Petitioner Lias' returns for such years were fraudulent (P.A. 1168a) and (b) on the same ground of fraud, upheld 50% penalties for all the years at issue (P.A. 1168a).

Before the Tax Court the Petitioners vigorously contested the deficiencies on the facts, but since the factual issues were generally determined against the Petitioners they will not be discussed here or in the succeeding Argument. In addition, there were a number of legal questions presented to the Tax Court and the Court below which will not be referred to in this Petition because they are not considered as involving grounds for certiorari.

Within the time allowed by statute, the Petitioners filed petitions to review the Tax Court's decisions with the United States Court of Appeals for the Fourth Circuit, within the jurisdiction of which (at Parkersburg, West Virginia) the Petitioners' federal income tax returns were filed. The jurisdiction of such Court was invoked under § 7482 of the Internal Revenue Code of 1954 (26 U.S.C. § 7482). The Court of Appeals, as previously indicated, affirmed the Tax Court's rulings.

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## REASONS FOR GRANTING THE WRIT AND ARGUMENT

### I.

### The Court Below in Affirming the Decision of the Tax Court That the Commissioner of Internal Revenue May Determine a Taxpayer's Taxable Income on a Consolidated Net Worth and Expenditures Basis Has Decided an Important Question of Federal Law Which Has Not Been, But Should Be, Settled by This Court.

In the succeeding section of this Argument (Part II), the Petitioners will endeavor to demonstrate that the Respondent's formula for determining taxable income in this case (which we refer to, for convenience, as the "consolidated net worth and expenditures" method or formula) has been used to shift the burden of proof as to fraud from the Respondent to the Petitioners. From the standpoint of the effect on these particular Petitioners, that may be the more important issue in the case in that the imposition of fraud penalties and the exposure of the Petitioner Lias to liability for closed years lifts the amounts involved to almost astronomical proportions. On the other hand, from the standpoint of taxpayers in general and as a matter of basic tax principles, the question as to whether the Respondent's formula may be used *at all* is the more important issue, one which the Petitioners believe should be decided by this Court.

The Court below and the Tax Court seem to have sanctioned the consolidated net worth and expenditures formula for three reasons: (1) the Respondent's deter-

minations of income are *prima facie* correct; (2) the formula is merely an adaptation of the individual net worth method, already fully sanctioned by this Court; and (3) the Petitioners invited the use of the method by creating a confusion of assets within the consolidated group.* However, none of these arguments can negate basic concepts that the formula is absolutely unique in federal income tax law, it involves a determination by the Respondent which is not within the basic framework of the Internal Revenue Code and it has many dangerous potentialities—all of which invite scrutiny by the ultimate authority on federal tax laws.

It is true that the Respondent's determinations with respect to federal tax liabilities are normally *prima facie* correct. On the other hand, the presumption of correctness disappears if the determination is arbitrary.

*Thomas v. Commissioner,* 232 F. (2d) 520 (C.A. 1, 1956)

*Thomas v. Commissioner,* 223 F. (2d) 83 (C.A. 6, 1955)

So far as the Petitioners have been able to determine, the consolidated net worth and expenditures formula is a novelty in federal tax law. The Tax Court, fully experienced in all methods of income determination, observed that the technique did "not appear to have been resorted to heretofore" (P.A. 1150a) and described it as "unusual" (P.A. 1150a). The use of a combined net worth formula in the case of married tax-

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* It is significant that in the Petitioner Lias' criminal trial, dealing with the years 1942 to 1946, inclusive, the Government employed an *individual* net worth and expenditures formula (R.A. 1099 *et seq.*).

payers, which has been occasionally sanctioned, is no precedent because the revenue statutes provide for joint returns.

Section 41 of the Internal Revenue Code of 1939 (26 U.S.C. 41) provides that "if no such (regular) method of accounting has been so employed (by a taxpayer), or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income * * *." While this gives wide latitude to the Commissioner to reconstruct a taxpayer's correct income on any reasonable basis, there is no authority or implication of authority to depart from the framework of the tax laws and combine the accounting of several separate taxpayers. There are many specific provisions of the Internal Revenue Code dealing with transactions between related taxpayers, with the allocation of income among affiliated groups and with the consolidation of income as in the cases of husband and wife and affiliated corporations, but none which would cover a situation such as the instant one. The implications of the consolidated net worth and expenditures formula cannot be restricted by pointing out that this involved a family group (if it can be called such) for the Courts below sanctioned the device, not because a family was involved, but because ownership of assets was confused and shifting, which would make it applicable to any group, large or small, related or not.

This Court, in the *Holland* case (*Holland v. United States*, 348 U.S. 121, 75 S. Ct. 127, 99 L. Ed. 150 (1954)), and companion cases, pointed out the many dangers

which lurk within the individual net worth formula and stated:

> "Nevertheless, careful study indicates that it is so fraught with danger for the innocent that the courts must closely scrutinize its use."
>
> * * * * * * *
>
> "Trial courts should approach these cases in the full realization that the taxpayer may be ensnared in a system which, though difficult for the prosecution to utilize, is equally hard for the defendant to refute."
>
> * * * * * * *
>
> "Appellate courts should review the cases, bearing constantly in mind the difficulties that arise when circumstantial evidence as to guilt is the chief weapon of a method that is itself only an approximation."

It should be obvious from these warnings that the method should not be drastically extended, as in the instant case, without careful consideration of the ultimate consequences, a consideration which only this Court can give the problem. Some of the dangers, we may add, are indicated in the application of the formula in the instant case as developed in the succeeding section of this Petition.

## II.

### The Decision of the Court Below Affirming the Decision of the Tax Court That the Petitioner Lias Was Guilty of Fraud With Intent to Evade Tax Is in Conflict With Applicable Decisions of Other United States Courts of Appeal in Cases Involving the Burden of Proof of the Commissioner of Internal Revenue With Respect to the Issue of Fraud.

The decision of the Tax Court on the issue of fraud in this case, which was affirmed and adopted by the Court below (the Court of Appeals based its opinion almost entirely on the Tax Court's opinion—see Appendix A), can be summarized as follows: (a) the use by the Respondent of the consolidated net worth and expenditures formula to determine the Petitioners' taxable income was proper under the circumstances, (b) by the application of such formula, it was determined that the taxable income of the Petitioner Lias in each of the years in issue was substantially understated on his returns, (c) such understatements of taxable income established a *prima facie* case of fraud and (d) Petitioners failed to prove that there was no justification for the imposition of fraud penalties and the assessment of deficiencies for taxable years barred by the statute of limitations.

In analyzing the opinion of the Tax Court, as approved by the Court below, it is apparent that it rests solely on the fact that the Respondent's application of the consolidated net worth and expenditures formula showed substantial discrepancies between the Petitioner Lias' reported taxable income and the income

constructed for *him* (*not* the consolidated group) by the Respondent. The Tax Court, if its Opinion be carefully analyzed, did not rely upon any other evidence as sustaining the Respondent's burden of proof on the fraud issue. Thus the Tax Court declared, after stating that the burden of proof on the fraud issue was on Respondent, that:

> "The repeated understatement of income in each of the taxable years by percentages ranging from a minimum of 137 per cent in 1946 to a maximum of 488 per cent in 1944 establishes a *prima facie* case of fraud" (P.A. 1163a).

In resting its decision on this one factor, the Tax Court, as well as the Court below, acted in direct conflict with several decisions of the United States Courts of Appeals which hold that it is incumbent upon the Commisioner of Internal Revenue, in any proceeding involving the issue of fraud, to prove the existence of fraud on the part of a taxpayer by clear and convincing evidence. Fraud may not be presumed, nor may it be inferred from suspicious circumstances; the Commissioner has the burden of proving *each* and *every* element necessary to sustain a finding of fraud. At no point in the chain of proof may the burden be shifted to the taxpayer.

As stated in *Davis v. Commissioner,* 184 F. (2d) 86 (C. A. 10, 1950):

> "Fraud implies bad faith, intentional wrong doing and a sinister motive. It is never imputed or presumed and the courts should not sustain findings of fraud by circumstances which at the most create only suspicion."

And again in *Drieborg v. Commissioner*, 225 F. (2d) 216 (C.A. 6, 1955), it was said:

> "At the outset it should be emphasized that the failure of the taxpayers to overcome the presumptive correctness of the deficiencies, even though those deficiencies cover a consecutive ten year period, cannot be regarded, in and of itself, as sufficient proof that the deficiencies or any part thereof were due to fraud on the part of the taxpayers. To hold otherwise would be to ignore the statute which imposes on the Commissioner the burden of proving fraud, and the often repeated admonition that such proof must be by clear and convincing evidence. There must be additional independent evidence from which fraudulent intent on the part of the taxpayer can be properly inferred."

The Court of Appeals for the Fifth Circuit has similarly described the burden of proof (*Bryan v. Commissioner*, 209 F. (2d) 822, (C.A. 5, 1954)), stating:

> "While ordinarily a determination of tax liability made by the Commissioner is presumptively correct and the burden rests upon the taxpayer to prove it erroneous, in any proceedings involving the issue of fraud with intent to evade tax, the burden of proof with respect to the issue of fraud is upon the Commissioner. Thus in any case where a deficiency in tax is determined by the Commissioner after the three year period of limitation has expired and the civil fraud penalty is asserted, the burden is upon the Commissioner, in an appropriate proceeding where the validity of an assessment based upon such determination is contested, to establish

by clear and convincing proof the existence of fraud."

See also:

*Commissioner v. Cutcliffe,* 163 F. (2d) 891 (C.A. 5, 1947), affirming 5 T.C.M. 673 (1946)

*Kastel v. Commissioner,* 136 F. (2d) 530 (C.A. 5, 1943)

The Respondent, the Petitioners submit, has failed to sustain his burden of proof in the instant case in the following respects:

*First,* and this is of the utmost significance, by his application of the consolidated net worth and expenditures method, the Respondent has avoided producing any specific evidence that the *individual* taxable income of the Petitioners was understated in any of the years involved;

*Second,* Respondent failed to offer any evidence of fraud in addition to the point that the Petitioners' taxable income *as so determined by the consolidated net worth and expenditures formula* was substantially understated in the taxable years; and

*Third,* Respondent failed to prove that the aggregate net worth of members of the consolidated group was correct, in that he neglected to offer evidence that the members of the group, other than the Petitioner Lias, had no amounts of cash on hand at the opening of the taxable period.

## *Argument.*

### A. *The Commissioner of Internal Revenue Used the Consolidated Net Worth and Expenditures Formula as a Substitute for Evidence to Sustain His Burden of Proof of Fraud.*

As pointed out in the preceding section of this Argument (Part I), there is grave doubt as to the propriety of using the consolidated net worth and expenditures formula even in determining a deficiency in income tax of a taxpayer, although normally the Commissioner's determination is accepted as *prima facie* correct and as placing the burden of proof on the taxpayer. There would seem to be far less justification for sanctioning the use of the formula to supply proof of fraud on the part of a member of the group, inasmuch as the formula, as applied in the instant case, by its very nature operates to avoid the Commissioner's burden and shift it to the taxpayer.

This inherent defect in the formula readily appears when we consider the last step in the determination of the Petitioner Lias' taxable income under the formula. After determining the "corrected" consolidated net income of the entire group, the Respondent arrived at the Petitioner Lias' share (and the share of both Petitioners for 1948) by deducting from the consolidated amount the individual amounts of taxable income reported by the others on their individual tax returns for the years involved. No evidence of any kind was offered to show that the amounts of taxable income so reported by the others were in fact the correct amounts. The Respondent did not call them as witnesses, nor did he attempt to compute their individual net worth changes. He

merely *assumed* their returns were correct. Thus the formula used by Respondent, by his own admission, is based squarely on a completely unproved assumption of fact.

The use of the formula in this case was found to be justified on the basis of the assertion that the assets of the consolidated group were so intermingled and the affairs of the group so confused that it was impossible to compute the individual net worth of the Petitioner Lias. If this be the fact, then it also follows that it was impossible to compute the individual net worth of other members of the group. It is thus difficult to see on what theory the taxable income of the others can be accepted as correct without proof and the balance of the consolidated net income be treated as the "correct" taxable income of the Petitioner Lias. The Respondent could just as well have accepted the Petitioner Lias' returns as correct and attributed the excess income to all or some or one of the other members of the group.

The Court below justifies this curious result of charging all the unreported consolidated income to Petitioner Lias, on the ground, in the words of the Court, that "no member of the group appeared to claim participation in excess of the amounts taxed to them", which practically echoes language of the Tax Court (P.A. 1156a) that the Respondent "was under no obligation to have them (the other members) sworn" and that the "inference may be drawn that, if called, their testimony would not have been favorable" to Petitioners. Since the issue was one of fraud, the Petitioner Lias could have no obligation to procure such testimony. Rather, it was Respondent's burden to prove, as prac-

tically all the authorities say, by clear and convincing evidence, that the other members of the group were *not* entitled to "participation in excess of the amounts taxed to them." The Court below, as well as the Tax Court, in conflict with well established principles of law, not only failed to require the Respondent to meet the burden of proof on this essential point, but in no uncertain terms shifted the burden to the Petitioners, thus failing to distinguish between the issue of tax liability and the issue of fraud.

The holding of the Courts below, is not only inconsistent with a great many decisions of the Courts of Appeal and the Tax Court itself,* but it has far-reaching effects of importance to all taxpayers. Its effect is to extend the concept of the *prima facie* correctness of the Commissioner's determination of a deficiency beyond the mere assessment of such deficiency to the imposition of fraud penalties based solely upon the taxpayer's failure to rebut the determination. The result is to obliterate the safeguards which Congress saw fit to provide to protect citizens against arbitrary and unwarranted assertions of fraud by the taxing authorities, safeguards which are particularly needful when Congress has at the same time provided the same authorities with drastic powers for assessing taxes. This is certainly a problem which deserves review by this Court.

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* See, for example, *A. W. Minyard*, 6 T.C.M. 1137 (1947); *Harry Gleis*, 24 T.C. 941 (1955); *A. C. Muldoon*, 12 T.C.M. 897 (1953).

B. ***The Respondent Failed to Introduce Any Evidence of Fraud Other Than the Determination of Substantial Amounts of Unreported Taxable Income as Computed Under the Consolidated Net Worth and Expenditures Formula.***

In addition to the question of the propriety of permitting the consolidated net worth and expenditures method to serve as a substitute for evidence fulfilling the Respondent's burden of proof, there is presented the closely related (and sometimes indistinguishable) question as to whether the mere existence of an understatement of income, based upon the application of such a formula, is by itself sufficient to sustain a finding of fraud. The Tax Court has not followed an entirely consistent policy on this point; however, in this case, as in many others, it has unequivocally held that substantial and repeated understatements of income developed through the application of the formula are *prima facie* proof that the taxpayer's returns were filed with fraudulent intent to evade tax.*

While certain of the Courts of Appeal have held that a proven understatement of income by a taxpayer creates an inference of fraud, which is sufficient to sustain the Commissioner's burden of proof on the issue, other Courts of Appeal in recent years have taken the

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* Although the Tax Court refers to the Petitioner Lias' stature as a witness and his illegal activities in discussing the fraud issue, a careful reading of the opinion makes it clear that it relies solely on the deficiencies as proof of fraud.

position that a finding of fraud cannot be based solely on proof of understatement, however substantial.

*Davis v. Commissioner*, 184 F. (2d) 86 (C.A. 10, 1950);

*Kashat v. Commissioner*, 229 F. (2d) 282 (C.A. 6, 1955)

*Goldberg v. Commissioner*, .... F. (2d) .... (C.A. 5, 1956)

In *Goldberg v. Commissioner, supra*, the taxpayer husband and wife were engaged in the business of operating coin machines, including some slot machines. The Commissioner reconstructed taxpayers' income by use of the "cash expenditures method" and assessed deficiencies and fraud penalties for five years. The Tax Court sustained both the deficiencies and fraud penalties, basing its finding of fraud on the fact that the wife was a trained accountant and that the taxable income as determined by the Commissioner was substantially in excess of that reported (reconstructed income was in amounts ranging from 200% to 400% over that reported). The Court of Appeals, reversing as to the fraud penalties, held that omissions of large amounts of income, large only because of the presumption in favor of the Commissioner's determination, cannot be substituted for clear and convincing evidence of fraud. The Court, pointing out that great stress had been placed on the criminal record of the husband taxpayer and his numerous brushes with the Federal taxing authorities, as was the situation in the instant case, went on to say that the case was tried too much on the theory "Give a dog an ill name and hang him."

In *Kashat v. Commissioner, supra*, the Tax Court sustained deficiencies and fraud penalties for six years

which had been determined by the Commissioner by use of the net worth and expenditures method. No evidence of fraudulent intent was offered other than the fact of substantial deficiencies. The taxpayer tried to explain away the deficiencies by claiming a substantial amount of cash on hand at the beginning of the net worth period but the Tax Court disbelieved his testimony as incredible and inconsistent and pointed out that even if it were true, there would still have been sizeable unexplained increases in net worth. In sustaining fraud penalties, the Tax Court said:

> "Where large amounts of income are not reported over a number of years, where no books are kept by the petitioner, and no reasonable explanation is given for the failure to report the income, there is substantial evidence to establish fraud."

However, on appeal, the Court of Appeals reversed the Tax Court's decision with respect to the penalties and the deficiencies for years barred by the statute of limitation, saying:

> "Standing alone, however, the failure of a taxpayer to overcome the presumptive correctness of the deficiency does not of itself create a presumption of fraud. Both parties to a proceeding may fail through inadequate proof on the several issues. We recently had occasion to consider this principle in *Drieborg v. Commissioner,* 6 Cir., 225 F. (2d) 216 and, after review of the pertinent cases, concluded there must be additional independent evidence from which fraudulent intent on the part of the taxpayer can properly be inferred and that the Commissioner cannot sustain the burden the Statute puts on him merely by establishing deficiencies in tax. There

are here no other circumstances to show deliberate intent to evade."

See also *Wisely v. Commissioner,* 185 F. (2d) 263 (C.A. 6, 1950), where the Court, in setting aside fraud penalties against a taxpayer who had failed to report large amounts of taxable income, stated:

"It is true that the additional payments by petitioner were large but this within itself does not establish as a matter of law that petitioner was guilty of fraud."

Thus, there is direct conflict in the decisions of the Courts of Appeal on this point, as to whether or not the Commissioner's burden of proof on the issue of fraud requires something more than a mere showing of understatements of income, especially where, as here, the supposed understatements are based on inference. The question is basic to the proper administration of the fraud provisions of the Internal Revenue Code and is an issue which has appeared time and time again before the Tax Court and the Courts of Appeal without final solution and will no doubt continue to appear.

C. *The Respondent Failed to Sustain His Burden of Proof in That He Failed to Substantiate the Opening Net Worth Used in the Consolidated Net Worth and Expenditures Formula.*

Still another departure from the established rule that the burden of proving *every* element of fraud is on the Commissioner was the Respondent's failure to establish clearly and convincingly the opening net worth used in applying the consolidated net worth and expenditures

formula. This Court has said in *Holland v. United States*, 348 U.S. 121, 75 S. Ct. 127, 99 L. Ed. 150 (1954):

> "We agree with petitioner that an essential condition in cases of this type is the establishment, with reasonable certainty, of an opening net worth, to serve as a starting point from which to calculate future increases in the taxpayer's assets. The importance of accuracy in this figure is immediately apparent, as the correctness of the result depends entirely upon the inclusion in this sum of *all* assets on hand at the outset." (Emphasis supplied)

If the Respondent is to compute the Petitioners' taxable income on the basis of increases in consolidated net worth, then it naturally follows that the "starting point", or opening consolidated net worth, must include all the assets of each and every member of the group. It is incumbent upon the Respondent, not only to include all such assets in opening net worth, but also to prove that such assets are *all* the assets of the group.

In the consolidated net worth statement prepared by Respondent in this case, no credit is given for amounts of cash held by Petitioner Lias or other members of the group on the opening date (December 31, 1941). With respect to the Petitioner Lias, the Tax Court found, and the Court below agreed, despite testimony to the contrary, that he had no reserves of cash, so that no complaint can be made on that score. However, there was no evidence warranting any finding that other members of the group had no cash on hand at the opening date and, on the contrary, Mr. Young, the agent who explained the Respondent's net worth schedules, specifically stated that he had not questioned any other members of the

group with respect to their cash holdings, nor did any other member of the investigating team, as far as he knew, make any such inquiry.

The opening net worth figure, as a result of this failure, is therefore based in part on supposition and not on the required clear and convincing evidence. The decision of the Court below in basing a finding of fraud upon a formula, which is in part supposition, is in direct conflict, not only with the decision of this Court in the *Holland* case, *supra*, but also with a recent decision of the Court of Appeals for the First Circuit, *Thomas v. Commissioner*, 232 F. (2d) 520 (1956), in which the Court, reversing deficiencies and fraud penalties sustained by the Tax Court because the Commissioner had failed to introduce any evidence of a positive nature that the taxpayer had no cash on hand at the beginning of the period, stated:

> "If respondent is to be permitted to make an arbitrary guess as to the proper figure for the cash on hand account, there would seem to be no reason as a general proposition why similar guesses should not be made as to each of the constituent elements comprising the taxpayers' net worth. Under these circumstances the entire net worth technique becomes nothing but an elaborate accounting sham lending a semblance of system and logic to a determination of deficiency which could have no greater validity than the original guesswork upon which it was based."

A situation somewhat similar to the one in the instant case occurred in *Bryan v. United States* 175 F. (2d) 223 (C.A. 5, 1949), involving criminal prosecution

for tax evasion for the years 1941 to 1944*. The Commissioner's auditor, who had constructed the net worth statement, testified that in arriving at opening net worth he had resorted to all the sources he could find, but he admitted that he did not know whether or not his computation included *all* the assets of the taxpayer. The taxpayer was convicted in the trial court but the Court of Appeals reversed because of the admission that opening net worth was not complete, stating:

> "* * * in view of the auditor's admissions that he was not able to say that his computation included all of the assets of the Defendant at the beginning of the period, together with the absence of any admissions, records, financial statements, bookkeeping entries, or other findings, or evidence, tending to bind the Defendant as to the lack of additional assets at the beginning of the tax period, the evidence, in the light of the bill of particulars, was insufficient to make out a *prima facie* case against the Defendant on the net worth-expenditure basis, and the case should not have been submitted to the jury since it did not exclude the hypothesis that the funds used in making some of the expenditures might have been from sources other than current business income."

In the instant case, although the Respondent may have offered proof convincing to the Tax Court that

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*Fraud penalties for the years 1935 to 1944 were sustained against the same taxpayer in *Bryan v. Commissioner*, 209 F. (2d) 822 (C.A. 5, 1954) but it does not appear that a similar admission with respect to the computation of opening net worth (for a different year than that involved in the criminal case) was made by the Government agent.

opening net worth was complete as to the Petitioner Lias, he did not fulfill the requirement with respect to group net worth, and, since he chose to use the consolidated formula, he should have made it equally complete.

### III. Conclusion.

As pointed out above, the decision of the Court below in respect to principles relating to the Respondent's burden of proof on the issue of fraud is, in several particulars, in direct conflict with decisions of other Courts of Appeal. Although this Court, in the *Holland* case, *supra*, and companion cases, has recently considered the application of the net worth method and the burden of proof in criminal fraud cases, a search of the decisions indicates that it has not done so in a civil fraud case. In view of the increasing conflict in the Courts of Appeal in regard to these matters, there is need for a definitive statement by this Court with respect to their application in a civil case.

Respectfully submitted,

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## APPENDIX A

**Opinion of the Court of Appeals for the Fourth Circuit.**

Before PARKER, Chief Judge, and SOPER and PRETTYMAN,* Circuit Judges.

PRETTYMAN, Circuit Judge: These are individual tax cases for the years 1942 to 1948, inclusive. The Tax Court of the United States sustained deficiencies and penalties totaling some $2,000,000. One taxpayer, our petitioner William G. Lias, is involved in all years, and his wife is jointly and severally liable for 1947 and 1948. The Tax Court made long and detailed findings of facts and rendered an exhaustive opinion.[1] To relate the background of this controversy, or to recite the underlying material upon which decisions of the present issues must be based, would be to repeat at considerable length what was said by the Tax Court. We see no need to do so. We shall therefore superimpose the following discussion upon the Tax Court's findings and discussion without repeating them.

Petitioners urge (1) that the Tax Court erred in approving the use of a net worth computation upon a family group basis as a means to the ascertainment of a single individual's net income; (2) that the net worth computation was erroneous, in that (a) the opening statement of assets was erroneous, (b) credit was not given petitioner for monies borrowed during the period involved, and (c) credit was not given for use of a cer-

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* Sitting in the Fourth Circuit by designation of the Chief Justice.

1. *William G. Lias*, 24 T. C. 280 (1955).

tain distributive share of the profits of one of the enterprises in which petitioner was engaged; and (3) that the Tax Court erroneously found fraud and erroneously found that the statute of limitations did not bar the deficiencies for 1942, 1943 and 1944.

The Supreme Court, in *Holland v. United States*,[2] approved the use of the net worth method of ascertaining net income in certain classes of cases. Even prior to that the Court had approved the use of the method where the owner of a network of gambling houses had received unreported income in a substantial amount.[3] The present case presents a situation similar to the ones faced in those cases. The application of the net worth method is thus firmly established. But petitioner urges that the Commissioner and the Tax Court in the case at bar extended the use of the method beyond permissible bounds.

The taxing authorities faced an unusual problem in attempting to ascertain the accuracy of the petitioner's income tax returns. During the taxable years here involved he received income from five partnerships, in which he and his brother, John Lias, were partners, and from seven corporations, or which he and members of his family were record owners. The revenue agents ascertained that the petitioner carried out many large cash transactions as to which no records were kept by him. He stated repeatedly to the agents that all assets, regardless of whether they were in the names of his wife, brother, mother-in-law or brothers-in-law, were

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2. 348 U. S. 121, 99 L. Ed. 150, 75 S. Ct. 127 (1954).

3. *United States v. Johnson*, 319 U. S. 503, 87 L. Ed. 1546, 63 S. Ct. 1233 (1943).

his to do with as he saw fit. He was unable to identify the source of funds used to acquire various assets. He refused to furnish a net worth statement. Corporate dividends were not paid in accordance with stock record ownership. Stocks of record were not in the names of the true owners. Bank accounts and assets other than cash were shifted from one name to another. The Tax Court found that 'The petitioner so conducted his own affairs and those of the 'Lias Group' as to make it impossible to identify the individual ownership of assets." Faced with this situation the revenue agents made a net worth computation on the Lias family group as a whole. They then allocated to the wife, brother, mother-in-law and brothers-in-law the amounts of net income on which they had paid income tax. The balance of the net income shown by the net worth computation they allocated to petitioner. When the case came on for trial before the Tax Court the Commissioner established with meticulous detail the computations of his agents. Petitioner took the stand and, without documentary or other support, proffered his explanations. He was on the stand for several days. The Tax Court concluded: "Making due allowance for the petitioner's unfortunate position the Court, after a considered appraisal, is not disposed to give any credibility to his unsupported testimony." The court also said "He was evasive, contradictory, and unresponsive."

Some of the figures are startling. For the year 1945, the year of the maximum tax deficiency, the total net income reported by the family group, as adjusted with the revenue agents, was $121,977.54, and the net income reported by petitioner was $76,336.18, or a total of $198,313.72. The net assets of the group increased by

$540,575.21 during that year, and total expenditures of $245,456.03 were made, indicating a consolidated net income of some $785,000. Among the events of the year was the issue to petitioner and his wife of stock in Laconia, Inc., at a cost of $235,194.98. For part of this stock Laconia, Inc., received a building known as the Firestone Building, which petitioner had purchased in 1944 for cash in the amount of $200,000, placing the title in the name of his wife. During the year 1945 petitioner purchased with cash $75,000 of United States Treasury Bonds. In that year a bank account in the name of petitioner and his brother, John, was closed out by transferring some $51,000 to a savings account in the name of petitioner and his wife. During the year petitioner and his wife purchased a residence for $46,000 cash. During the year he advanced $69,676.34 to Laconia, Inc., on open account, and the next year, against the cash thus advanced, stock was issued to petitioner, his wife, his brother, his nephew, and the latter's wife. During the year 1945 five new bank accounts were opened and seven were closed. The agents found that during the year cash was advanced to Wheeling Downs, Inc., in the amount of $167,500. These details are not recited as a full explanation of the computations but are given as illustrative of the factual background with which the cases are concerned.

The agents were unable to find property in any considerable amounts belonging to members of the family. The various partnerships and corporations were all engaged in gambling enterprises of some sort, and the petitioner was undoubtedly the owner, backer and operator of those enterprises. The Tax Court found as a fact that the bank accounts and certain real estate and stock be-

longed to the petitioner. It found that "It was the practice of the petitioner to place bank accounts, real estate, and stock in the names of others than the true owners." In this respect the Tax Court made reference to findings made by the United States District Court for the Northern District of West Virginia in connection with the appointment of receivers for the petitioner and five corporations alleged to have been owned and controlled by him.[4] These were five of the seven corporations here involved. The Tax Court concluded:

> "While the consolidated family net worth technique does not appear to have been resorted to heretofore, we think its use is permissible as embraced within the scope of the net worth technique in civil cases of the character under consideration and involving the complexities and unprecedented circumstances presented. In our opinion no substantial injury results to the petitioner. Extraordinary situations require the adoption of unusual methods to resolve them. Mindful of the pitfalls inherent in any net worth method, we approve the respondent's use of the consolidated net worth method in the instant proceedings."

We agree with the foregoing statement.

Petitioner says that the Commissioner's computation of the opening net worth of the family group was erroneous. This net worth was $164,732.97. Petitioner says (Brief, pp. 68-69) that an examination of the entire record "leaves one with a firm conviction that he was a man of substantial means up to and including January

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4. *United States v. Lias,* 103 Fed. Supp. 341 (1952) *aff'd,* 196 Fed. (2d) 90 (4th Cir. 1952).

1, 1942, and that he had accumulated savings as of the beginning of the period of between $850,000 and $950,000, which included about $700,000 in cash." In the first place petitioner offered no evidence whatsoever to support a claim of any such amounts of savings or cash. He says in his brief that "It is totally unrealistic, in view of the uncontradicted evidence in this case as to the extent of the taxpayer's bootlegging and gambling activities in the 1920's and 1930's, and in view of * * * his mode of living and his successful businesses throughout the period prior to the starting period," to make a finding that he had no cash. Petitioner himself offered no evidence persuasive to the Tax Court as to large amounts of savings or cash as of January 1, 1942, and, as we have indicated, none of his family except one took the witness stand. No documentary proof was offered. In the second place the revenue agents, despite an exhaustive and meticulous search, were unable to uncover any evidence of substantial savings or cash. In the third place the petitioner conclusively established to the Commissioner of Internal Revenue, when his returns for the years up to 1941 were under consideration, that he had no funds whatsoever. The details are recited by the Tax Court in its opinion. From 1937 through 1941 the revenue authorities were actively endeavoring to find property of the petitioner with which to meet his tax liabilities. The taxpayer made numerous offers in compromise based upon inability to pay, and at one point he gave a series of postdated checks on the ground that he then had no funds with which to meet his obligations. We agree with the Tax Court that the petitioner utterly failed to establish error in the Commissioner's opening net worth statement.

Petitioner urges that the allocation of the group net income among the several members of the group was erroneous. The question is: If this total income was the income of the group, what part of it was the income of each member? This is a problem of presumption and proof. The Tax Court found, as we have indicated, that petitioner frequently carried his own assets in the names of his wife, his brother, and others. It found that it was impossible to separate the individuals and compute their several net worths. It found, as we have indicated, that petitioner owned the assets involved. As the matter came to the Tax Court, the Commissioner had determined that the shares of the persons other than petitioner were the amounts reported by them as income, after the adjustments made with the revenue agents. That determination was at that point presumptively correct.[5] The whole matter was then opened wide before the Tax Court. But no member of the group appeared to claim participation in excess of the amounts taxed to them. None appeared on the witness stand except a brother-in-law, and he did not claim ownership of any such excess amount. The Tax Court heard petitioner for days and did not believe his shifting of the burden to the other members of his family. As we have already emphasized, no documentary proof was presented. On the other hand the Commissioner produced much proof, and the findings and opinion of the Tax Court are replete with facts indicating that petitioner and his operations were the source of the income. Upon this state of the record we cannot say that the conclusions of the Tax

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5. *Helvering v. Nat. Grocery Co.*, 304 U. S. 282, 82 L. Ed. 1346, 58 S. Ct. 932 (1938).

Court as to the true owners of this income are clearly erroneous. We must therefore affirm the findings.

The other points raised by petitioner, which we have listed in the beginning of this opinion, are discussed and disposed of in the findings and opinion of the Tax Court. We agree with that court's treatment and disposition of the items.

The amounts of net income found by the Tax Court to have been omitted from the petitioner's tax returns, and the circumstances under which the omissions are shown to have occurred, are amply sufficient to support the fraud penalties.

Fraud having been established, the statute of limitations does not apply.

Affirmed.

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# In the Supreme Court of the United States

OCTOBER TERM, 1956

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No. 754

WILLIAM G. LIAS, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE

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WILLIAM G. LIAS and ALICE B. LIAS, PETITIONERS

*v.*

COMMISSIONER OF INTERNAL REVENUE

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT*

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## BRIEF FOR THE RESPONDENT IN OPPOSITION

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### OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 1101a-1169a)[1] are reported at 24 T. C. 280. The opinion of the Court of Appeals (Pet. 32-39) is reported at 235 F. 2d 879.

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[1] Unless otherwise indicated, all references are either to the appendix to the petitioners' brief filed in the Court of Appeals (designated "R."), or references to the appendix to the Commissioner's brief below (designated "Supp. R.").

JURISDICTION

The judgments of the Court of Appeals were entered on August 3, 1956. (Pet. 2.) An order denying a petition for rehearing was entered on September 11, 1956. (Pet. 2.) On November 14, 1956, this Court entered an order extending the time for filing a petition for a writ of certiorari to and including February 8, 1957. (Pet. 2.) The petition for a writ of certiorari was filed on February 7, 1957. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTIONS PRESENTED

1. Whether, in approving the use of the net worth method to determine the taxpayer's true income, the tests enunciated by this Court in *Holland* v. *United States,* 348 U.S. 121, and related cases, were correctly applied by both courts below, upon the basis of their conclusions that during the taxable period the taxpayer kept no adequate records, had many likely sources of income (mostly gambling enterprises), acquired a substantial amount of assets held in his own name and in the names of others, and had been properly credited with assets on hand at the beginning point, including cash.

2. Whether the courts below correctly concluded that the returns in question for the taxable period had been filed with intent to evade, so as to warrant imposition of the 50 per cent fraud penalty.

STATUTE AND REGULATIONS INVOLVED

Sections 22, 41, 51, 54, 275, 276 and 293 of the Internal Revenue Code of 1939, and Section 29.54-1 of Treasury Regulations 111 are printed in the Appendix, *infra,* pp. 38-40.

STATEMENT

The testimony in these cases is contained in 7,150 pages of typewritten transcript, and more than 400 exhibits were introduced. (R. 1168-1169a.) The Tax Court made lengthy findings of fact. (R. 1104a-1146a.) The Court of Appeals, seeing no need (Pet. 32) "to repeat at considerable length what was said by the Tax Court," simply superimposed its discussion of the cases "upon the Tax Court's findings." The following is a summary of the more important findings of fact, and of the evidence germane to the issues here involved.[2]

*History of the taxpayer prior to the taxable period.* Beginning at an early date, and continuing until about 1930, the taxpayer was engaged in bootlegging. In connection with this activity, he was convicted, sentenced, and fined in four cases in the United States District Court for the Northern District of West Virginia for violation of the National Prohibition Act. On January 9, 1923, he received a six months' sentence and was fined $1,000; on January 24, 1924, he was fined $750; on May 12, 1926, he received a sixteen months' sentence and a fine of $5,500; and on November 12, 1930, he received a two-year sentence and was fined $10,000. On appeal from the last conviction, the United States Court of Appeals for the Fourth Circuit affirmed (*Lias* v. *United States,* 51 F. 2d 215, affirmed, 284 U. S. 584).

[2] William G. Lias will hereafter be referred to as the taxpayer. Although he and his wife, Alice B. Lias, filed a joint return for the year 1948, she will hereafter be referred to as the taxpayer's wife. The so-called Lias Group consists of the following individuals: the taxpayer; John Lias, his brother; the taxpayer's wife; Mary Koutroumanos, mother of the taxpayer's wife; Gregory Koutroumanos and William Koutroumanos, brothers of the taxpayer's wife; and the taxpayer's two children, George B. Lias and Antoinette Lias. (The surname Koutroumanos will hereafter be referred to, as in the Tax Court, as Manos.) (R. 1140a.)

During the taxpayer's bootlegging activities the governmental authorities seized and confiscated considerable quantities of illicit liquor and transportation equipment. (R. 1109a.)

On December 12, 1930, the taxpayer began a numbers business in Wheeling, West Virginia, and in nearby Ohio and Pennsylvania towns, in partnership with one George Seibert and one Mike Russell. In 1931 the taxpayer's only source of income was from the numbers business. On December 16, 1931, Seibert, Russell, and the taxpayer had an accounting of their numbers partnership. At that time the profit in that business was approximately $27,000. The partners agreed to draw $900 each from the partnership. The taxpayer and Seibert each withdrew his share and Russell loaned his share to the taxpayer, who was leaving to commence a prison sentence. (R. 1109a-1110a.)

From December 17, 1931, to April 18, 1932, the taxpayer was confined in the Federal Reformatory Camp in Petersburg, Virginia, when, in connection with the conviction on November 12, 1930, he was transferred to the Federal penitentiary in Atlanta, Georgia, until his release on July 23, 1933. His interest in the numbers partnership continued during his confinement in the penitentiary. (R. 1110a.)

When, in 1931, the taxpayer learned that he would be required to serve the sentence imposed on November 12, 1930, he persuaded his brother, John, to come to Wheeling to look after his interest in the numbers partnership. John did not receive any compensation until January 1, 1933, when he was paid $50 per week. (R. 1110a.)

In 1934, the partnership between Seibert, Russell,

and the taxpayer was terminated. Thereupon, the taxpayer and his brother, John Lias, formed a partnership under the name of Wheeling Book Company, which partnership continued until late 1937, when the numbers business was outlawed. (R. 1110a-1111a.)

Prior to the year 1933 the taxpayer filed no federal income tax returns. Sometime in 1932 he learned that income derived from illegal enterprise was subject to tax. In 1933, an investigation of the taxpayer's income tax liability for the years 1929, 1930 and 1931 was begun. The taxpayer was interviewed on October 31, 1933, by special agents, at which time he stated that he had been advised not to discuss his business with them unless he was granted immunity from prosecution and that they would never learn the true facts unless he explained them. He also stated that if the special agents were interested only in determining the amount of his tax he would cooperate and pay whatever tax was determined. In the course of their investigation, the agents had learned of fictitious accounts which pertained to the numbers business. The taxpayer denied any connection with the fictitious accounts or the numbers business. On July 30, 1934, a preliminary 30-day letter was sent to the taxpayer, asserting deficiencies and penalties for 1928 through 1931, totaling $45,675.15. The taxpayer's income for the years 1928, 1929, and 1931 had been determined on a basis of an analysis of three bank accounts in his name, and of certain fictitious accounts. On April 26, 1935, jeopardy assessments were made for the 1928, 1929, and 1931 deficiencies. On May 10, 1935, a notice of deficiency was sent to the taxpayer who, on July 19, 1935, filed a petition with the Tax Court of the United States (formerly the United States Board of Tax Appeals),

putting the aforementioned deficiencies in issue. (R. 1111a-11113a.)

On April 10, 1935, the taxpayer was indicted for willfully attempting to defeat and evade income taxes for 1931 in the sum of $122,000. He was tried on that indictment and was acquitted on July 27, 1935. (R. 1113a.)[3]

Just prior to the criminal trial, in 1935, the taxpayer admitted his connection with the numbers business and claimed for the first time that he had only a one-third interest in the business. George Seibert, one of the alleged partners, objected to his name and share appearing on the 1934 partnership return and had not admitted to the revenue agents his interest in the numbers business. (R. 1114a.)

On November 30, 1937, an offer in compromise of the taxpayer's civil and criminal liabilities was filed. By power of attorney dated January 10, 1938, the taxpayer empowered David S. Goldberg to appear before the Bureau of Internal Revenue and the Tax Court with respect to his tax matters for the years 1917 to 1938. Under date of March 24, 1938, Goldberg sent a letter enclosing an installment offer in compromise dated March 22, 1938. On each of the dates March 22, May 4, and May 17, 1938, the taxpayer paid $1,000 upon

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[3] On April 26, 1948, the taxpayer was indicted for willfully attempting to defeat and evade his taxes for the years 1942 to 1946, inclusive, the years under consideration in this case. On November 9, 1948, he pleaded guilty to the fifth count of the indictment, involving the year 1946, and the first four counts were dismissed by the United States District Court for the Northern District of West Virginia. He was sentenced to five years, and fined $10,000. On January 21, 1949, he moved to withdraw his guilty plea, which motion was granted, and the sentence and fine were vacated. On May 10, 1949, the taxpayer was reindicted, pleaded not guilty, and, after jury trial, was acquitted on July 2, 1949. (R. 1141a.)

the compromise offer. The taxpayer subsequently defaulted in the balance of payments under his offer. (R. 1114a-1115a, 1116a.)

Pursuant to a stipulation filed May 4, 1938, the Tax Court entered a decision for deficiencies and penalties, as follows (R. 1115a):

| Year | Deficiency | 50 per cent penalty | 25 per cent penalty | Total |
|---|---|---|---|---|
| 1928 | $ 838.88 | $419.44 | $209.72 | $1,468.04 |
| 1929 | 74.68 | 37.34 | 18.67 | 130.69 |
| 1931 | 1,659.38 | 829.69 | 414.85 | 2,903.92 |

The taxpayer's returns for the years 1934 and 1935 were investigated, and a notice of deficiency was issued April 12, 1938. A petition was filed with the Tax Court. On April 1, 1941, Goldberg sent a letter to the Collector of Internal Revenue enclosing an offer in compromise on behalf of the taxpayer, dated March 31, 1941. No remittance or financial statement accompanied the offer and it was returned by the Collector. The offer provided for payment of $2,500 in compromise of the unpaid deficiences for 1934 and 1935 and for the 1937 tax returned. On May 16, 1941, the taxpayer wrote to the Collector of Internal Revenue, enclosing a check for $50 to apply on his income taxes for past years. (R. 1117a-1118a.)

Between May 20, 1935, and January 1, 1945, thirteen warrants were issued for the taxpayer's delinquent taxes. Ten warrants were issued prior to May 27, 1941. One warrant issued January 21, 1942, was paid April 1, 1942, and two issued on January 1, 1945, for additional taxes were paid promptly. In November 1942, after having met some payments and having defaulted on others, the taxpayer gave a check for approximately $5,500 in full settlement of the balance due. (R. 1118a-1119a.)

Examinations of the taxpayer's income tax returns for 1940 and 1941 were made, and a deficiency notice was sent under date of October 5, 1943. A petition contesting the deficiences was filed with the Tax Court on November 19, 1943. Pursuant to stipulation, a decision was entered on October 28, 1944, for deficiencies of $577.58 and $5,063.78, respectively. (R. 1119a.)

*Returns filed and income reported for the taxable years.* The taxpayer filed individual returns for the years 1942 to 1947, inclusive, and he and his wife filed a joint return for 1948, reporting the following amounts of net income (R. 1140a):

| Year | Income Reported |
|---|---|
| 1942 | $ 98,283.74 |
| 1943 | 81,023.26 |
| 1944 | 86,109.59 |
| 1945 | 76,336.18 |
| 1946 | 135,429.68 |
| 1947 | 127,773.13 |
| 1948 | (17,928.71) (joint return) |

*Income determined by Commissioner for taxable period; deficiencies and penalties asserted.* On the basis of an analysis of increases in net worth, the taxpayer's corrected net income was determined to be as follows (R. 1142a-1144½a):

| | |
|---|---|
| 1942 | $140,895.66 |
| 1943 | 266,635.15 |
| 1944 | 420,379.20 |
| 1945 | 662,992.79 |
| 1946 | 185,470.47 |
| 1947 | 323,985.61 |
| 1948 | 40,880.60 |

The resulting deficiencies and fraud penalties are as follows (R. 1102a):

| Year | Deficiency | 50% Penalty |
|---|---|---|
| 1942 | $ 33,325.45 | $ 16,662.73 |
| 1943 | 161,770.79 | 80,885.39 |
| 1944 | 303,360.57 | 151,680.29 |
| 1945 | 554,837.86 | 277,418.93 |
| 1946 | 49,020.92 | 24,510.46 |
| 1947 | 166,562.75 | 83,718.88 |
| 1948 | 17,662.02 | 8,831.01 |

*The inadequacy of records as warrant for use of the net worth method.* Numerous personal accounts of the taxpayer and of his wife were kept in the records of two corporations, Automatic Cigarette Sales Company (the owner and operator of slot machines, coin vending and music machines), and Zeller's Steak House, Inc. (a restaurant which carried on some gambling activities).[4] However, the Tax Court found that the taxpayer kept no permanent personal books of accounts or records from which the agents could determine his income. (R. 545a-546a, 1106a, 1120a.)

The returns for 1942 to 1948, inclusive, were prepared by David S. Goldberg, a certified public accountant, from information taken from books of the corporations and partnerships in which the taxpayer had an interest, from receipts, cancelled checks, check stubs, purchase and sales slips, and statements of stockholders, from records of interest on bank accounts, from information furnished by brokers, sellers and purchasers as to realty transactions, and by the taxpayer's wife as to rents, and from information which the taxpayer supplied orally, usually near the close of the year. (R. 32a, 1120a.)

The books of the partnerships and corporations in which the taxpayer had an interest were kept by bookkeepers employed by the organizations, and not by the taxpayer's accountant. The taxpayer had employed

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[4] As noted hereafter, the taxpayer's sources of income during the taxable years comprised, in the main, many partnerships and corporations, some of which carried on substantial illegal gambling activities.

Mr. Goldberg, in 1936, in connection with the various enterprises, but the accountant did not make any of the original records concurrently with the transactions they reflected. Goldberg's records were prepared from primary records made by employees of the various organizations. He made up weekly or monthly statements and work papers on the basis of the information given him and such limited verification as he could make, and from these he prepared the tax returns for the enterprises and for the individual members of the Lias Group. (R. 1119a-1120a.)

Goldberg was not engaged in any of the activities of the various enterprises, legal or illegal (he was a stockholder in Greiner's, Inc., and this was the only investment he had in any of the taxpayer's enterprises), and he could not be certain whether the information supplied to him was complete or accurate. In this connection, he testified that during the taxable period involved, he was employed full time, eight hours a day and six days a week, as comptroller for a department store, and also performed accounting services for many clients in addition to the taxpayer. He stated that "not very much" time was devoted by him to the taxpayer's affairs. (R. 13a, 1120a; Supp. R. 18.)

None of the other witnesses called by the taxpayer could testify from personal knowledge of the facts that all of the income of any of the gambling enterprises was recorded and reported. For example, there was testi-

mony that many of the tickets of Reuthers, Inc., showing gambling wins or losses, had been destroyed or were not in existence and could not be checked, and the books of that corporation had never been audited. Similarly, the evidence as to the books of the Automatic Cigarette Sales Company showed that they were kept by a Miss McGill, who took orders from the taxpayer. Many entries were made in those books on the taxpayer's oral instructions only. Miss McGill did not make the entries on the collection sheets but these were made by slot machine collectors, who did not testify at the hearing below. She simply posted the entries from those sheets. The books of the Automatic Cigarette Sales Company did not show the numbers or locations of the slot machines, which were never inventoried. Collection sheets were only partially available for 1942 and were not available for 1943 and 1944. The missing collection sheets could not be found, and there was no way of checking with the location proprietors who took the figures which the corporation gave them. In 1942, 1943 and 1944, the taxpayer drew from the corporation the respective amounts of $35,000, $60,000 and $50,000, without having any record made. The amounts were later recorded as year end adjustments, based on the taxpayer's oral statements.[5] The agents

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[5] The taxpayer's appropriation of the $50,000 item, and its ultimate reflection in the records of Automatic Cigarette Sales Company, was explained by Goldberg as follows (R. 147a-148a):

Q. Did you find something in the books of Automatic that caused you to make inquiry with reference to that?

were unable to audit the records of the Automatic Cigarette Sales Company, and its income could not be adequately determined from the records alone. (R. 147a-148a, 150a, 438a, 440a, 460a, 469a, 477a, 856a, 859a, 863a-864a, 1165a; Supp. R. 69-70, 120, 721, 737.)

The various gambling partnerships were owned by an alleged partnership known as Lias Brothers, an outgrowth of a former gambling partnership known as Wheeling Book Company. The only records available

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A. No, sir; that was information voluntarily given me by Mr. Lias.

Q. That occurred during the month of November?

A. Well, the entry was made in the month of November, so I would say the information came to me in the month of November, 1944. I am not specific as to the date. I received the information on a Sunday.

Q. You were engaged in the auditing of the books at that time or were examining the books at that time?

A. No, sir; I was waiting for a bus and Mr. Lias came along and picked me up in his car. While he rode me out to my home, he told me about the fact that he sold some machines for $50,000 and he wanted to keep the money, was going to keep the money. At that time I told him I would put the entry on the books. He said "O.K."

Q. Did he tell you whose machines he had sold?

A. The machines of the Automatic.

Q. Did he tell you how many he had sold?

A. No, sir.

Q. Did he tell you to whom he had sold them?

A. No, sir.

Q. Did you make a check of the records of Automatic to determine what machines were sold?

A. No, sir.

Q. I believe you testified you had nothing to do with these records, is that correct?

A. Outside of making journal adjustments at the end of each month, I had nothing to do with the records, as such.

Q. And you never made an audit of these records, Automatic's records?

A. Not as such, no sir.

for Lias Brothers were tax returns and such records of the individual underlying partnerships as were extant. There were no formal partners' accounts on the gambling partnership books, such as they were, and distributive shares to Lias Brothers could not be determined. The individuals who kept such records as there were for the Acorn Club, Silver Dollar, Club Paddock, and the Point Pleasant Amusement Company (other partnerships in which petitioner was interested, see p. 21, *infra*) did not testify. The accountant for the Acorn Club admitted that the books of that gambling enterprise were kept by others, and he could not vouch for their correctness. The books of the Market Street Club were at best single entry records consisting of a daily journal showing wins and losses which were summarized, recapped and entered on weekly or monthly statements. Goldberg admitted he could make no audit of the game slips of the Market Street Club, and that all that he could do was to make an arithmetical calculation as to the difference between the ins and outs and the total for the wins or losses for the day, and then check that against the bank account. (R. 18a, 22a-24a, 102a; Supp. R. 4, 7-9, 32-33, 37, 146.)

*Evidence that the taxpayer's net worth increases were attributable to currently taxable income.*

(a) *Taxpayer's interests.* The Tax Court concluded that during the taxable years, as well as for some years prior thereto, the taxpayer "maintained varying interests in partnerships and corporations, most all of which derived their income from gambling activities embracing many forms." The Tax Court found that the taxpayer had received income from these partnerships and corporations during the taxable period. In addition, the taxpayer admitted that he also derived

income from individual gambling. In his 1943 return, he had claimed a gambling loss deduction exceeding $20,000. When questioned as to an item of $35,000 appearing as slot machine receipts on his 1942 return, he described one of its possible sources as gambling winnings. He also testified that he had won money on election bets. (R. 1105a-1106a, 1121a, 1147a; Supp. R. 890.)

The partnerships from which the taxpayer derived income were as follows:

Lias Brothers was a partnership in which the taxpayer and his brother, John Lias, were partners. Lias Brothers had interests in other partnerships, which were operated throughout the following designated periods under the following names: Acorn Club, a gambling and horse book establishment in Bridgeport, Ohio (1942-1948); Point Pleasant Amusement Company, a slot machines enterprise in Point Pleasant, West Virginia (1942); Club Paddock, a night club, restaurant, bar, and gambling casino (1937-1944); Market Street Club, horse book and gambling casino, Wheeling, West Virginia (1942-1948), the gambling activities of which included three crap tables, a chuck-a-luck, or hazard game, a roulette wheel, and a black jack game; and Pirate Cafe, a restaurant, bar, and gambling establishment in South Wheeling, West Virginia (1942-1948). (R. 1105a-1106a.)

The corporations from which the taxpayer derived income were as follows: Automatic Cigarette Sales Company, owner and operator of slot machines, coin vending and music machines (1942 to 1945); Zeller's Steak House, Inc., operating a restau-

rant[6]; Reuther's, Inc., conducting a horse book operation, and a restaurant (1945 to 1948); Greiner's, Inc., a retail store handling radios, records, and electrical appliances (1944 to 1948); Laconia, Inc., a real estate holding company (1944 to 1948); Wheeling Downs, Inc., owner of the grounds, buildings, and equipment of the racetrack known as Wheeling Downs (1945-1948); and Wheeling Downs Racing Association, the operator of the racetrack under lease from Wheeling Downs, Inc., (1946-1948). (R. 1106a-1109a.)

(b) *Elimination of nontaxable sources.* The Tax Court found that during the taxable years the taxpayer had not received any money or property either by gift or inheritance. (R. 1142a.)

*The establishment of a definite opening net worth.*

(a) *The Government's investigation of leads.* The Tax Court found that the revenue agents had made an extensive investigation from all available sources for the purpose of constructing a net worth statement. The Court of Appeals concluded that the revenue agents had conducted "an exhaustive and meticulous search," that the net worth computation had been "established with meticulous detail," and that in the course of the investigation the agents had been "unable

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[6] Zeller's Steak House, Inc., also carried on some gambling activity. Organized in July, 1941, it was active until April, 1949, when its property was destroyed by fire. (The evidence showed that on April 8 or 9, 1949, there had been a fire on the premises of Zeller's Steak House, Inc.) On September 27, 28 and 29, 1951, mutilated monies in the respective amounts of $45,000, $35,000, and $29,000 were delivered by an employee of the Wheeling Downs Racing Association to a bank for deposit or exchange. In November, 1951, $15,000 in mutilated or burned money was turned over to the taxpayer by an employee of the Market Street Club and was sent to the United States Treasury for redemption. (R. 19a, 545a-546a, 1145a.)

to find property in any considerable amounts belonging to members of the family," other than the taxpayer. (R. 1121a; Pet. 34, 35, 37.)

(t *The establishment of cash on hand at the beginnin int.* As of December 31, 1941, the taxpayer was credited with the sum of $2,847.53, representing cash in banks. He claimed that at the beginning of the net worth period, he alone, without reference to other members of the Lias Group, had between $850,000 and $950,000 cash reserves on hand. He had testified that in June, 1926, he had $219,000 in concealed currency, and that by June, 1936, it had increased to $620,000. The Tax Court, however, concluded that "the record discloses a great deal of credible evidence which negates the existence of any secreted currency as of January 1, 1942." Similarly, the Court of Appeals concluded that the taxpayer had "offered no evidence whatsoever to support a claim of any such amounts of savings or cash," that "the revenue agents, despite an exhaustive and meticulous search, were unable to uncover any evidence of substantial savings or cash," and that the taxpayer had "conclusively established to the Commissioner of Internal Revenue, when his returns for the years up to 1941 were under consideration, that he had no funds whatsoever." The Court of Appeals agreed with the Tax Court that the taxpayer had "utterly failed to establish error in the Commissioner's opening net worth statement." (R. 1143a, 1151a, 1152a; Pet. 37.)

Among the facts which the Tax Court found in support of the conclusion that the taxpayer had no funds or property beyond the amounts allowed at the beginning of the period on January 1, 1942, were the following:

In an interview with a special agent in August, 1933, the taxpayer stated that he never filed tax returns because he was always "broke"; that he had made money in the past, but had spent it as fast as he made it; that the overhead in the liquor racket in which he had been engaged, including attorney fees, was heavy. In September, 1933, it was necessary for the taxpayer to borrow $2,000 from his sister in order to make a trip to California. In October, 1933, the taxpayer told two special agents that he had no business and no source of income. At a conference in 1934 to discuss proposed deficiences for the years 1928 to 1931, inclusive, it was represented that the taxpayer was "broke", and his representatives cited the borrowing of $2,000 from his sister as proof of such fact. In 1934, a mortgage of $6,000 was foreclosed on the taxpayer's home, and the property was purchased by his brother, John. In January, 1935, the United States District Court of the Northern District of West Virginia issued a writ under which the United States Marshal seized property of the taxpayer for collection of unpaid fines, in the sum of $3,808.70, imposed for violation of the National Prohibition Act. The balance of these fines was not paid until December, 1946. (R. 1111a-1113a.)

In April, 1935, the taxpayer was indicted for willfully attempting to evade and defeat taxes owing for 1931, in the sum of $122,000. He was acquitted. In November, 1937, through his accountant, David S. Goldberg, the taxpayer submitted an offer in compromise of his civil and criminal liabilities and forwarded a check for $1,000 to the Department of Justice in connection with the offer, expressing an intention to send further payments until the full tax liability was discharged. He expressed regret that he could not send more, but that it was impossible to do so because of

general business conditions. He stated that his entire working capital would be depleted if he attempted to pay the entire amount. The Department of Justice suggested the submission of an installment offer of $10,400. Such an offer was submitted on March 24, 1938, and in it the taxpayer stated that the sum of $10,400 represented his true tax liability for years prior to January 1, 1934. In explanation of the taxpayer's failure to meet his original offer, it was stated that the taxpayer had been unable to obtain the money from two specific sources (from George Seibert, and from a deposit in a Pennsylvania bank). Aside from these two sources, the taxpayer's representative advised that the taxpayer had no cash to pay, was obligating himself to the fullest extent, and that the cash that the taxpayer did have at that time represented his only working capital, and was extremely necessary for the operation of his business. On each of the dates March 22, May 4, and May 17, 1938, the taxpayer paid $1,000 upon the compromise offer. On May 4, 1938, the Tax Court, on stipulation, entered a decision for deficiences and penalties, as follows: 1928, $1,468.04; 1929, $130.69; 1931, $2,903.92. On June 6, 1938, Goldberg, the taxpayer's representative, wrote to the Department of Justice that the taxpayer was unable to meet a $500 payment due on June 1. On August 4, 1938, Goldberg again wrote the Department that the taxpayer was unable to make his monthly installment payments, that he (Goldberg) had done everything that he could to effect a settlement of the taxpayer's liabilities, and that it might be better to contact the taxpayer directly. A deputy collector contacted the taxpayer in August, 1938. He was advised that the taxpayer could not pay his taxes, but would make every effort to do so within sixty days. Several months thereafter, the taxpayer

advised the deputy collector that he had no money, that he could not obtain any, and that he was not making any in his business at that time. (R. 1113a-1116a.)

The taxpayer made numerous defaults on his offer in compromise. In November, 1939, a special agent interviewed him for the purpose of determining his ability to pay. At that interview the taxpayer stated that he was unable to pay the amount of the offer because practically everything he had was tied up in Automatic Cigarette Sales Company, and he was putting all money back into the business as it came in. On November 16, 1939, in order to settle his tax liabilities, the taxpayer delivered to the Collector of Internal Revenue thirteen postdated checks of Automatic Cigarette Sales Company, totalling $7,400. (R. 1116a-1117a.)

In July, 1939, Goldberg advised the Bureau of Internal Revenue that the taxpayer was not in a financial position to pay the expenses of a trip to Washington by his representatives. In the same month, Goldberg sent another letter in which he advised that the taxpayer would be unable to proceed with a case pending before the Tax Court, involving deficiences for 1934 and 1935, because his financial condition was such that he was unable to pay any tax, or the costs of a trial. In April, 1940, Goldberg wrote a letter to the internal revenue collector in which deferment of two monthly installments of $300 each was requested, in order to enable the taxpayer to meet postdated checks totalling $500. It was reported that taxpayer's business had been bad, and that the burden of meeting monthly payments of $800 would be too much. (R. 1117a-1118a.)

In April, 1941, Goldberg sent a letter to the collector of internal revenue enclosing an offer in compromise. No remittance or financial statement accompanied the

offer; it was returned by the collector. The offer provided for payment of $2,500 in compromise of unpaid deficiences for 1934 and 1935, and for the 1937 tax returned. The offer, based on inability to pay, stated that the taxpayer had paid such large income taxes in the past several years that he was unable to meet his obligation without either borrowing the full amount or depleting his working capital to the danger point. In May, 1941, the taxpayer wrote to the collector, enclosing a check for $50 on account of income taxes for past years. The letter expressed regret that circumstances did not permit the taxpayer to send more at that time. (R. 1118a.)

Between May 20, 1935, and January 1, 1945, thirteen warrants were issued for the collection of the taxpayer's delinquent taxes. In July, 1939, the taxpayer told the deputy collector that he could not pay the sum of $4,500 then due. In September, 1939, the taxpayer arranged for consecutive monthly payments of $300. He made numerous defaults in these payments in 1939 and 1940. He made no payments after September, 1940, despite repeated contacts by the deputy collector. In November, 1942, the taxpayer submitted a check for approximately $5,500 in full settlement of the balance owing. During the period 1938 to 1941, inclusive, the collector made repeated efforts to locate assets out of which collections could be made, but without avail. (R. 1118a-1119a.)

*Evidence as to the taxpayer's net worth increases during the taxable period; the net worth computation.* The Tax Court found that the agents had made an extensive investigation of all available sources for the purpose of building up a net worth statement. Included in the net worth computation for the taxable period were assets, held in the names of the members of the

Lias Group, in seven corporations (Automatic Cigarette Sales Company, Greiner's, Inc., Laconia, Inc., Reuther's, Inc., Wheeling Downs, Inc., Wheeling Downs Racing Association, Zeller's Steak House, Inc.), and in four partnerships (Acorn Club, Market Street Club, Pirate Cafe, Point Pleasant Amusement Company). In addition, the net worth computation reflected the following assets in the names of the members of the group: cash in banks, Series "E" savings bonds, Treasury bonds, stocks, accounts receivable and payable, deeds of trust, and interests in realty. These assets had been discovered by searching public records, canvassing banks, examining the books and records of the various enterprises involved, and in many other ways. (R. 1121a-1122a, 1143a-1144a.)

The Tax Court found that when the agents asked the taxpayer about assets, they were repeatedly informed that the assets held in the names of members of the Lias Group were the property of the taxpayer, to do with as he saw fit.[7] Similarly, the Court of Appeals observed that the agents "were unable to find property in any considerable amounts belonging to members of the family" and that the taxpayer "was undoubtedly the owner, backer and operator" of the various partnerships and corporations which were engaged in gambling enterprises of some sort. (R. 1121a-1122a; Pet. 35.)

The Tax Court found that the following Schedule A, the facts and figures of which it found to be correct, set forth in composite form the total assets for the taxa-

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[7] As we discuss more fully below, (see pp. 34-36 *infra*) the basic fallacy in the taxpayer's position in this Court is the assumption that assets included in the net worth analysis for the taxable years constituted, to any substantial extent, property belonging, not to taxpayer, but to the several members of the Lias Group.

ble period which were held in the names of the members of Lias Group, and that the following Schedule B, the facts and figures of which it also found to be correct, sets forth the additions and deductions necessary to project the so-called consolidated net income of the family group, from which was deducted the net income, as reported or adjusted, of John Lias, Alice B. Lias, Gregory Manos and William Manos,[8] in order to determine the taxpayer's corrected net income (R. 1142a-1144½a):

[8] As we further note below, (see p. 36, *infra*) the deduction, for the taxable years involved, of the reported, or adjusted, net income of these members of the Lias Group from the so-called consolidated net income of the family group (in reality the net income of the taxpayer alone) was entirely consistent with the Government's theory of the case, to the extent that the other members of the group actually reported the taxpayer's net income. To the extent their returns reflected their own income, the deduction from the so-called consolidated net income of the family group obviously was a gratuitous credit to the taxpayer.

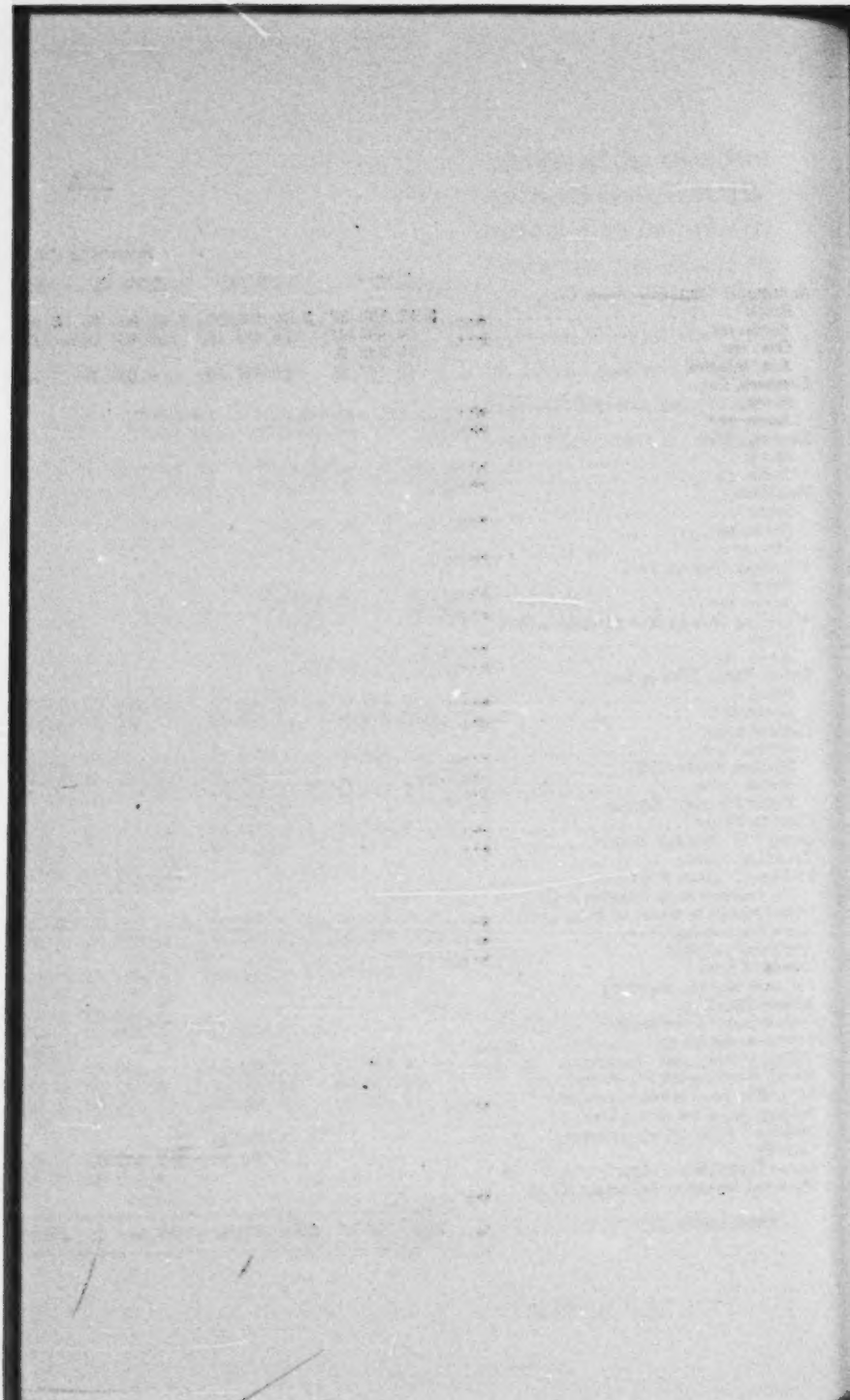
(Here follows 1 Paster, Schedule "A")

SCHEDULE "A"

| | 12/31/41 | 12/31/42 | 12/31/43 | 12/31/44 |
|---|---|---|---|---|
| Automatic Cigarette Sales Co. | | | | |
| Stock | $ 82,900.00 | $ 82,900.00 | $ 82,900.00 | $ 82,900.00 |
| Accts. rec. | (8,666.07) | (34,165.45) | (26,567.01) | (57,137.7 |
| Div. rec. | 16,580.00 | — | — | — |
| Acc. salaries | 19,197.50 | 20,447.50 | 8,286.76 | 10,786.4 |
| Greiners, Inc. | | | | |
| Stock | — | — | — | — |
| Accts. rec. | — | — | — | — |
| Laconia, Inc. | | | | |
| Stock | — | — | — | — |
| Accts. rec. | — | — | — | — |
| Reuthers | | | | |
| Stock | — | — | — | — |
| Accts. rec. | — | — | — | — |
| Div. rec. | — | — | — | — |
| Wheeling Downs, Inc. | | | | |
| Stock | — | — | — | — |
| Accts. rec. | — | — | — | — |
| Wheeling Downs Racing Association | | | | |
| Stock | — | — | — | — |
| Accts. rec. | — | — | — | — |
| Zellers Steak House, Inc. | | | | |
| Stock | 30,000.00 | 30,000.00 | 30,100.00 | 30,100.0 |
| Accts. rec. | (30,868.06) | 15,280.80 | 550.05 | (11,917.6 |
| Partnerships: | | | | |
| Acorn Club | 505.09 | 738.32 | 1,313.10 | 3,140.1 |
| Market Street Club | — | 18,613.15 | 58,960.15 | 50,009.6 |
| Pirate Cafe | 7,118.23 | 6,104.70 | 10,602.86 | 7,389.9 |
| Point Pleasant Amuse. | — | 5,000.00 | — | — |
| Cash in banks | 2,847.53 | 51,743.35 | 41,251.56 | 173,585.6 |
| Series "E" Savings Bonds | — | 14,925.00 | 26,193.75 | 60,318.7 |
| Treasury Bonds | — | — | 74,000.00 | 149,000.0 |
| Stocks—Masten & Co. | — | — | 88,012.13 | — |
| Cr. balance with Masten & Co. | — | — | 1,999.75 | (200.0 |
| Other stocks in name of John Lias | $ 5,000.00 | $ 5,000.00 | $ 5,000.00 | $ 5,000.0 |
| Accounts receivable | 12,500.00 | 12,500.00 | 12,500.00 | 12,500.0 |
| Accounts payable | — | — | — | — |
| Deeds of trust | (3,383.78) | (5,906.59) | (10,604.45) | (9,023.3 |
| Aul and Shively Building | — | — | 14,625.00 | 16,562.5 |
| Musee Building | — | — | 9,650.00 | 9,183.3 |
| Community Apartments | — | 32,430.00 | 31,590.00 | 35,232.3 |
| Firestone Building | — | — | — | 199,444.4 |
| Filling station and equipment | 8,397.53 | 7,492.08 | 6,586.63 | 5,678.1 |
| 90-92 Washington Street property | 19,180.00 | 18,760.00 | 18,340.00 | 17,920.0 |
| 54½ Warwood Avenue property | 3,425.00 | 3,100.00 | 2,775.00 | 2,450.0 |
| Adding machine (John Lias) | — | — | — | — |
| 20th and Main Street property | — | 8,000.00 | — | — |
| Garage | — | 7,000.00 | 7,000.00 | 7,000.0 |
| Lot—Tridelphia District | — | — | 2,100.00 | 2,100.0 |
| Personal residence—Detroit, Mich. | — | — | — | — |
| Total assets | $164,732.97 | $299,962.86 | $497,075.28 | $802,022.7 |

SCHEDULE "A"

| 12/31/42 | 12/31/43 | 12/31/44 | 12/31/45 | 12/31/46 | 12/31/47 | 12/31/48 |
|---|---|---|---|---|---|---|
| $ 82,900.00 | $ 82,900.00 | $ 82,900.00 | $ 82,900.00 | $ 82,900.00 | $ 82,900.00 | $ 82,900.00 |
| (34,165.45) | (26,567.01) | (57,137.74) | (31,955.59) | 28,625.91 | 66,637.31 | 71,675.82 |
| — | — | — | — | — | — | — |
| 20,447.50 | 8,286.76 | 10,786.76 | 7,500.00 | — | — | — |
| — | — | — | 15,000.00 | 15,000.00 | 15,000.00 | — |
| — | — | — | (15,000.00) | 5,000.00 | 5,000.00 | — |
| — | — | — | 235,194.98 | 621,894.98 | 621,894.98 | 621,894.98 |
| — | — | — | 69,679.34 | 10,790.00 | 44,910.00 | (9,000.00) |
| — | — | — | 9,000.00 | 9,000.00 | 9,000.00 | 9,000.00 |
| — | — | — | (4,000.00) | — | — | — |
| — | — | — | — | — | 2,000.00 | — |
| — | — | — | — | 265,000.00 | 265,000.00 | 365,000.00 |
| — | — | — | 167,500.00 | 14,982.13 | 584,955.46 | 419,985.66 |
| — | — | — | — | — | 25,000.00 | 25,000.00 |
| — | — | — | — | (12,784.23) | (12,784.23) | (600.00) |
| 30,000.00 | 30,100.00 | 30,100.00 | 50,100.00 | 50,100.00 | 50,100.00 | 50,100.00 |
| 15,280.80 | 550.05 | (11,917.05) | (30,130.33) | (44,601.85) | (29,446.49) | (22,871.01) |
| 738.32 | 1,313.10 | 3,140.15 | 4,433.60 | 7,120.93 | 10,081.69 | 11,488.82 |
| 18,613.15 | 58,960.15 | 50,009.65 | 49,273.53 | 3,029.80 | 10,499.13 | 3,372.42 |
| 6,104.70 | 10,602.86 | 7,389.62 | 2,036.85 | 2,300.62 | 1,977.72 | 1,144.09 |
| 5,000.00 | — | — | — | — | — | — |
| 51,743.35 | 41,251.56 | 173,585.62 | 350,987.11 | 80,644.12 | 8,241.14 | 7,719.74 |
| 14,925.00 | 26,193.75 | 60,318.75 | 60,318.75 | 150.00 | 150.00 | 150.00 |
| — | 74,000.00 | 149,000.00 | 224,000.00 | 224,000.00 | — | — |
| — | 88,012.13 | — | — | — | — | — |
| — | 1,999.75 | (200.00) | — | — | — | — |
| $ 5,000.00 | $ 5,000.00 | $ 5,000.00 | $ 5,000.00 | $ 5,000.00 | $ 5,000.00 | $ 5,000.00 |
| 12,500.00 | 12,500.00 | 12,500.00 | 12,500.00 | 14,750.00 | 12,750.00 | 12,750.00 |
| — | — | — | (25,000.00) | (26,250.00) | (143,000.00) | (75,000.00) |
| (5,906.59) | (10,694.45) | (9,023.82) | (8,334.49) | — | — | — |
| — | 14,625.00 | 16,562.50 | 23,295.44 | — | — | — |
| — | 9,650.00 | 9,183.33 | 8,716.66 | — | — | — |
| 32,430.00 | 31,590.00 | 35,232.37 | — | — | — | — |
| — | — | 199,444.46 | — | — | — | — |
| 7,492.08 | 6,586.63 | 5,678.18 | 4,772.73 | — | — | — |
| 18,760.00 | 18,340.00 | 17,920.00 | 17,500.00 | — | — | — |
| 3,100.00 | 2,775.00 | 2,450.00 | 2,125.00 | 1,800.00 | 1,475.00 | 1,150.00 |
| — | — | — | 84.41 | 75.37 | — | — |
| 8,000.00 | — | — | — | — | — | — |
| 7,000.00 | 7,000.00 | 7,000.00 | 7,000.00 | — | — | — |
| — | 2,100.00 | 2,100.00 | 2,100.00 | 2,100.00 | — | — |
| — | — | — | 46,000.00 | 46,000.00 | 46,000.00 | 46,000.00 |
| $299,962.86 | $497,075.28 | $802,022.78 | $1,342,597.99 | $1,406,627.78 | $1,683,341.71 | $1,626,860.52 |



SCHEDULE "B"

| | 1942 | 1943 | 1944 | 1945 | 1946 | 1947 | 1948 |
|---|---|---|---|---|---|---|---|
| Increase in net worth | $135,229.89 | $197,112.42 | $304,947.50 | $540,575.21 | $ 64,029.79 | $276,713.93 | ($ 56,481.19) |
| Add: Federal income and gift taxes paid | 23,366.08 | 112,808.35 | 109,480.65 | 94,986.21 | 184,723.82 | 119,047.89 | 110,351.65 |
| Insurance premiums paid | 2,288.82 | 11,903.67 | 1,031.88 | 41,088.35 | 74.31 | — | — |
| Nondeductible portions of capital loss | — | — | — | — | — | — | 7,135.43 |
| Other personal items | 41,885.66 | 58,566.06 | 86,192.50 | 109,381.47 | 91,996.73 | 32,348.74 | 21,305.51 |
| | 202,770.45 | 380,390.50 | 501,652.53 | 786,031.24 | 340,824.65 | 428,110.56 | 82,311.40 |
| Less: Nontaxable portion of capital gain | — | (1,300.00) | (2,348.75) | (1,060.91) | (1,761.55) | (2,881.48) | — |
| Corrected consolidated net income | 202,770.45 | 379,090.50 | 499,303.78 | 784,970.33 | 339,063.10 | 425,229.08 | 82,311.40 |
| Less: Net income reported or adjusted | | | | | | | |
| John Lias | 36,678.10 | 72,009.18 | 70,449.44 | 77,937.07 | 104,996.96 | 66,955.74 | 11,467.17 |
| Alice B. Lias | (581.85) | 13,392.17 | 8,475.14 | 13,472.87 | 1,763.75 | 3,252.96 | Joint return |
| Gregory Koutroumanos | 11,299.48 | 12,632.00 | — | 30,567.60 | 46,831.92 | 31,034.77 | 17,413.19 |
| William Koutroumanos | 14,479.06 | 14,422.00 | — | — | — | — | 12,550.44 |
| Total net income reported or adjusted | 61,874.79 | 112,455.35 | 78,924.58 | 121,977.54 | 153,592.63 | 101,243.47 | 41,430.80 |
| Corrected net income of William G. Lias | 140,895.66 | 266,635.15 | 420,379.20 | 662,992.79 | 185,470.47 | 323,985.61 | 40,880.60 |
| Less: Net income reported by William G. Lias | 98,283.74 | 81,023.26 | 86,109.59 | 76,336.18 | 135,429.68 | 127,773.13 | (17,928.71) |
| Unreported income | $ 42,611.92 | $185,611.89 | $334,269.61 | $586,656.61 | $ 50,040.79 | $196,212.48 | $ 58,809.31 |

*Proof that the assets of the Lias Group, used in the net worth computation, constituted the assets of the taxpayer, so that the so-called consolidated net worth of the Lias Group was in substance the taxpayer's net worth.* As noted above, the Tax Court found that the taxpayer had repeatedly informed agents of the revenue service that the assets in the names of members of the Lias Group were his property, to do with as he saw fit. The Tax Court also found that record ownership of stocks, bonds, bank accounts, and brokerage accounts was no indication of true ownership; that segregation of the assets of each member of the Lias Group was an impossibility; that there was no record as to how much belonged to each member of the family; that assets were shifted from one name to another from year to year; and that money was intermingled and not earmarked. The Tax Court concluded that the taxpayer had "so conducted his own affairs and those of the 'Lias Group' as to make it impossible to identify the individual ownership of assets," and that "as a fact * * * the bank accounts, certain real estate, and the stock from which the income in question arises, belonged to petitioner."[9] (R. 916a-917a, 1149a, 1160a; Supp. R. 616, 649, 744; Pet. 33-34, 35-36, 38.)

In this context, the Tax Court made the following additional findings of fact:

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[9] The Court of Appeals—observing that the Tax Court had found "that petitioner owned the assets involved," that the Tax Court had not believed the taxpayer's "shifting of the burden to the other members of his family," and that "the Commissioner produced much proof, and the findings and opinion of the Tax Court are replete with facts indicating that petitioner and his operations were the source of the income"—concluded that "[u]pon this state of the record we cannot say that the conclusions of the Tax Court as to the true owners of this income are clearly erroneous." (Pet. 38-39.)

1. The taxpayer took the funds of the Wheeling Book Company, a partnership in which he and his brother, John Lias, were partners, to set up the Automatic Cigarette Sales Company, in which no interest appeared for them. He used funds of the latter corporation to set up Zeller's Steak House, Inc., the Market Street Club, the Pirate Cafe, the Point Pleasant Amusement Company (with interests to outsiders), and the Globe Amusement Company, with no interest in John Lias. (R. 1141a.)

2. Various bank accounts were opened in the names of John Lias, Mary Manos, and Alice B. Lias, with a total opening balance of $2,847.53 on January 1, 1942. The taxpayer referred to the money deposited in those accounts as "Lias money," "John's money," "family money," and "group money." (R. 1125a.)

3. In 1942, the taxpayer purchased the Community Apartments in his wife's name for cash, at a cost of $32,430. In 1945, the property was transferred to Laconia, Inc., for 350 shares of its capital stock. In 1947, the taxpayer filed a gift tax return covering the transfer of the property to his wife in 1942. The balance of the bank account in which rents on the property were deposited was transferred to the taxpayer's account in the same bank. (R. 1127a.)

4. On March 15, 1943, the taxpayer purchased the Aul and Musee Buildings in the name of his mother-in-law at a cost of $25,000, executing a purchase money mortgage for $10,000. Improvements to the property were made at a cost of $2,500 in 1944, $7,357.94 in 1945, and $4,580.55 in 1946. Income and losses from the buildings were included in the taxpayer's income in the deficiency notice covering the years 1943 to 1946, in-

clusive. The taxpayer's mother-in-law had no property; her sons claimed her as a dependent in 1937, and for the period 1939 to 1942, inclusive. The Aul and Musee Buildings were transferred to Laconia, Inc., for 320 shares of its capital stock, valued at $32,000, issued in the name of the taxpayer's mother-in-law, and transferred in 1946 for the benefit of the taxpayer's two children. (R. 1129a.)

5. In 1942, 1943, and 1944, the taxpayer purchased United States Series E Bonds, costing $60,168.75, in his wife's name. However, he reported the interest on these bonds as his own income. He sold the bonds in 1946, and purchased the Laconia Building with the proceeds. (R. 1127a.)

6. In 1943 the taxpayer purchased securities in a brokerage account with Masten & Company. The account stood in his wife's name at one time, and his wife's and mother-in-law's names at another. His mother-in-law owned no interest in the account. The taxpayer reported all dividends, except those on three securities, as his own income, (R. 1128a-1129a.)

7. In October, 1944, the taxpayer purchased the Firestone Building for cash, at a cost of $200,000, and he placed title in the name of his wife.[10] In 1945, the property was transferred to Laconia, Inc., for 2,000 shares of stock which were spit equally between the taxpayer and his wife. (R. 1129a.)

8. In September, 1945, a joint bank account standing in the names of the taxpayer and his brother was closed out by transferring $51,316.08 to a savings account in the names of the taxpayer and his wife, and by with-

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[10] He filed a belated gift tax return in 1947, covering the transfer to his wife. (R. 1129a.)

drawing $49,000 which the taxpayer used to help buy the Firestone Building in Pittsburgh. (R. 1122a.)

9. In 1945, stock of Laconia, Inc., having a cost of $235,194.98 (including the stock issued for the Community and Firestone Buildings), was issued to the taxpayer and his wife. In 1945, the taxpayer advanced $69,679.34 to Laconia, Inc., on open account. In 1946, stock of that corporation, charged against total cash of $104,700 advanced by the taxpayer, was issued in varying proportions to the following: the taxpayer; his brother; his wife; his brother-in-law, George W. Lias; and his child, Antoinette Lias. The taxpayer filed a gift tax return in 1947, reporting the stock issued to the others as gifts. Of the amounts which the taxpayer advanced to Laconia, Inc., $30,000 came from bank accounts in the names of his wife and children, the interest on which the taxpayer has reported as his own income in his returns for 1946, 1947 and 1948. (R. 1130a.)

10. In December, 1946, during the investigation made by the revenue agents, the stock of Automatic Cigarette Sales Company and of other corporations was transferred for the ostensible purpose of conforming record ownership with true ownership. In November, 1948, the stock was reshifted, with the taxpayer as a minority stockholder. The transaction which effected the reshifting was a sham. (R. 172a, 1025a-1036a, 1145a, 1148a-1149a, 1160a-1161a; Supp. R. 429, 1164-1165, 1169, 1173, 1176-1177.)

11. Dividends of stock of Reuther's, Inc., held in the name of one Samuels, were paid to the taxpayer and were reported by him in his returns for 1946 and 1948. (R. 1123a.)

12. Dividends of Automatic Cigarette Sales Company were paid to the taxpayer's mother-in-law, although the stock was held in the name of his wife, and were paid to stockholders previously of record after their shares had been transferred. (R. 1122a-1123a.)

Additional evidence tending to support the findings below may be summarized as follows: With respect to the taxpayer's claim that his brother, John Lias, had entrusted him with substantial sums, variously stated as $100,000, $115,000, $118,000, and $200,000 (constituting an alleged liability to be taken into consideration in the net worth computation), the taxpayer had told a special agent, in 1947, that whenever he used his brother's money he later made an accounting with him. However, he admitted that he had kept no records of any accounting. John Lias did not testify. Overmeier, the taxpayer's accountant, admitted that he had found no record that John Lias had invested any money. Goldberg admitted that he had no evidence of John Lias' contributions, except oral statements of both the taxpayer and his brother. As to the taxpayer's claim that he had given his brother a note to cover the alleged advances, Goldberg testified that he never inquired as to the location of the note, and the taxpayer informed his secretary that he had destroyed it. John Lias allegedly brought his sum of money, exceeding $100,000, to Wheeling, in 1931. The total income which he had reported for the entire period 1924 to 1931, inclusive, was $9,471.70. In 1932, his reported income was $2,600, and in 1933, it was $3,500. (R. 229a, 452a-454a, 534a, 599a-601a, 750a, 1156a, 1157a; Supp. R. 186, 204, 575, 624, 658.)

Gregory Manos was the only member of the Lias Group, other than the taxpayer, who testified below.

Among other things, he stated that neither he nor his brother, William Manos, put any cash into either the Automatic Cigarette Sales Company or the Market Street Club; that he drew a salary of $100 a week; that he endorsed over to the taxpayer his dividends and bonuses from both of those companies (including $30,000 received from the Market Street club in 1945, and $48,000 received in 1946); that he kept no notes or memoranda concerning moneys turned over to the taxpayer; and that he took no interest in what the taxpayer would do with the money As to the so-called family agreement of November 1, 1948, which purported to be an accounting between the taxpayer, John Lias, Gregory Manos, and William Manos, Gregory Manos testified that he accepted it without question or inquiry; that he knew nothing of the employment of accountants to draft it; and that he had never examined the schedules which recited that he owned large interests in the Automatic Cigarette Sales Company. He admitted that minutes of that corporation, reciting that he had turned slot machines over to it for original stock, were false; that in fact he never owned $3,000 worth of slot machines, as recited in the minutes, and had made no such proposal; and that he never had $7,000 in cash to put into the business, as the minutes recited. He could not explain why the certificates were issued to him and could not remember putting any cash in the business. (R. 363a, 494a-525a; Supp. R. 224-317.)

The Tax Court concluded that the November 1, 1948, agreement was "a sham and without substance," and that the attempted transfers shown therein "were without consideration and * * * without validity." In this connection, the Tax Court found that there were no rec-

ords to show that the amounts listed on the schedules attached to the agreement were left in the Lias enterprises; that in listing those amounts, the taxpayer's accountant had relied upon oral statements of the taxpayer and his brother, John Lias, that all moneys reported as income were left with the taxpayer for investment; that there were no personal books of the taxpayer or of the other members of the family group to establish the interfamily financial relationships; and that the only available records were some check stubs and cancelled checks. (R. 1160a-1161a.)

*Indicia of fraud.* The Tax Court found that during the taxable period, the taxpayer received income from illegal gambling and slot machine activities. He did not record his numerous transactions in permanent personal books of accounts or records, and maintained no records adequate to enable the Commissioner to determine his correct income. When questioned as to an item of $35,000 which appeared as slot machine receipts on his 1942 return, he gave several conflicting explanations. He used large amounts of cash in many transactions throughout the taxable years, involving listed stocks, real estate, United States bonds, bank accounts, and the income therefrom. Even when checks were received, they were cashed and not deposited. He refused to supply the revenue agents with a net worth statement, and refused to make any statement as to the amount of cash on hand as of January 1, 1942. He admitted that assets which constituted his property, to do with as he saw fit, were kept in the names of the other members of the Lias Group, and the Tax Court concluded that the taxpayer, "deliberately and with purposeful design," so conducted his own affairs and

those of the Lias Group as to make it impossible to identify the individual ownership of assets. As to the November 1, 1948, agreement which purported to establish the ownership of certain stock in other members of the Lias Group, as noted above, the Tax Court concluded that it was "a sham and without substance," and that the attempted transfers therein were "without consideration * * * and without validity." (R. 1105a-1106a, 1120a, 1121a-1122a, 1145a, 1146a, 1148a, 1149a-1150a, 1151a-1152a, 1161a.)

The Tax Court further found that there had been a "repeated understatement of income in each of the taxable years by percentages ranging from a minimum of 137 per cent in 1946 to a maximum of 488 per cent in 1944.[11] The Court of Appeals agreed that the "amounts of net income found by the Tax Court to have been omitted from the petitioner's tax returns, and the circumstances under which the omissions are shown to have occurred, are amply sufficient to support the fraud penalties." (R. 1144½a, 1163a; Pet. 39.)

ARGUMENT

1. The court below, affirming the Tax Court, held that the Commissioner properly had employed the net worth method in determining income tax deficiencies and penalties of more than two million dollars against the taxpayer for the years 1942 through 1948.[12] The decision is correct, applying principles of law, relevant

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[11] These percentages reflect a credit to the taxpayer for the total income of $671,499.16 reported by other members of the Lias Group during the same period. (R. 1144½a.)

[12] A joint return having been filed for 1948, the deficiencies and penalties involved for that year were assessed against both the taxpayer and his wife.

to cases of this type, which this Court first enunciated in *United States* v. *Johnson*, 319 U.S. 503, and more recently in *Holland* v. *United States*, 348 U.S. 121, and related cases.[13] The taxpayer in this case was a slot machines, race track and realty operator. Primarily, however, he was—as was the taxpayer in *Johnson*, 319 U.S. at pp. 515, 517,—"a gambler on a magnificent scale," and the fact that his "gambling transactions were on an enormous scale was overwhelmingly established". In the circumstances, it was, of course "not to be expected that the actual financial transactions of such a vast illicit business would appear by direct proof," (319 U.S. at 517) and, since the taxpayer kept no personal books and records from which his true income could be determined,[14] resort to the net worth method was of course permissible, if not required (*United States* v. *Johnson*, 319 U.S. at 517; *Holland* v. *United States*, 348 U.S. at 124, 130-132).

Both the Tax Court and the Court of Appeals in effect agreed that the evidence in this case fully met the tests which this Court prescribed in *Holland* and related cases in order to insure proper use of the indirect method of determining correct income.[15] For example:

(1) *Opening net worth was definitely established.* The Tax Court found that there had been (R. 1121a) "an

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[13] *Friedberg* v. *United States*, 348 U. S. 142; *United States* v. *Calderon*, 348 U. S. 160; *Smith* v. *United States*, 348 U. S. 147.

[14] Both courts below agreed as to this. (R. 1146a; Pet. 33.)

[15] Those tests were prescribed in the context of criminal tax cases. Although they may be applicable to civil tax cases as well, obviously the quantum of proof by which the Government must sustain deficiencies and penalties in a civil tax case involving fraud is less than its burden in a criminal case. *Helvering* v. *Mitchell*, 303 U. S. 391, 397; *Holland* v. *United States*, *supra*, p. 126.

extensive investigation from all available sources," and, with respect to the taxpayer's claim of a substantial amount of cash on hand at the starting point (R. 1152a), "the record discloses a great deal of credible evidence which negates the existence of any secreted currency as ot January 1, 1942." The Court of Appeals concurred, concluding that the taxpayer had (Pet. 37) "offered no evidence whatsoever to support a claim of * * * savings or cash" of between $850,000 and $950,000, including about $700,000 in cash, but that, on the contrary, he had "conclusively established to the Commissioner of Internal Revenue, when his returns for the years up to 1941 were under consideration, that he had no funds whatsoever."

(2) *The Government did not fail to investigate all possible leads as to the taxpayer's assets on hand at the starting point.* As the Court of Appeals concluded, the agents had conducted (Pet. 37) "an exhaustive and meticulous search," the taxpayer himself had "offered no evidence persuasive" in the matter, and "none of his family except one took the witness stand." That one, the taxpayer's nephew, Gregory Manos, offered no relevant leads to the detection of any additional assets at the starting point. (R. 494a-525a; Supp. R. 224-317.)

(3) *Nontaxable sources of the alleged net worth increases were negatived.* The Tax Court found that during the taxable years in question the taxpayer (R. 1142a) "did not receive any money or property either by gift or inheritance." As to amounts which the taxpayer allegedly borrowed from his brother, John Lias, under the guise of a contribution, exceeding $100,000, to the family pool in 1931, the Tax Court on the basis of the taxpayer's testimony and of the income tax returns

filed by John Lias for years prior to 1931, found that (R. 1157a) on the "undisputed evidence, and the fact that John was not a witness in these proceedings, the petitioner's claim respecting the sum of $118,000 appears to the Court to be incredible." [16]

(4) *The assets included in the net worth computation were proved to be the assets of the taxpayer.* The Tax Court found that when the agents questioned the taxpayer as to specific assets which had been discovered (R. 1121a-1122a, 1148a), "he stated repeatedly that all assets, regardless of whether they were in the names of his wife, brother, mother-in-law, or brothers-in-law, were his to do with as he saw fit." The Tax Court further found that (R. 1160a, 1161a) "the bank accounts, certain real estate, and the stock from which the income in question arises, belonged to the petitioner." Significantly, it found that the agreement of November 1, 1948—a belated attempt, triggered by the investigation in the case, to establish majority ownership of the stock in others—was (R. 1161a) "without consideration" and "without validity." The Court of Appeals agreed (Pet. 38) "that petitioner owned the assets involved." Noting that the Tax Court "did not believe * * * [the

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[16] Even assuming, contrary to the government's position in *United States* v. *Ford*, 237 F. 2d 57, certorari granted February 25, 1957, No. 794, this Term, that proof of likely sources of additional income attributed to the taxpayer was essential, there was abundant proof of such sources. The Tax Court concluded that (R. 1147a): "Dating from his release from the penitentiary in 1933, and continuing through the taxable periods in question, the petitioner has maintained varying interests in partnerships and corporations, most of which derived their income from gambling activities embracing many forms." The Court of Appeals agreed that (Pet. 35): "The various partnerships and corporations were all engaged in gambling enterprises of some sort, and the petitioner was undoubtedly the owner, backer and operator of those enterprises."

taxpayer's] shifting of the burden to the other members of his family," that, on the other hand, "the Commissioner produced much proof, and the findings and opinion of the Tax Court are replete with facts indicating that petitioner and his operations were the source of the income," it affirmed those findings.[17]

The basic fallacy of the taxpayer's position in this Court, as below, is the erroneous assumption, underlying both points of his argument (Pet. 13-24), that the net worth computation used by the Commissioner reflects assets actually owned by members of the Lias Group other than the taxpayer, and the consequent, erroneous conclusion that what both courts below described as a consolidated family net worth—merely as a matter of descriptive convenience—was, in a literal sense, the composite net worth of the individual members of the Lias Group. This fundamental error underlies the taxpayer's contentions that use of the net worth method here required that the net worth computation reflect the opening assets of the various members of the Lias Group other than the taxpayer, and that, to the extent that it did not do so, there was a failure of proof as to fraud. The answer to these contentions is twofold: (1) Assuming, *arguendo,* that the taxpayer's theoretical position is correct, his conclusions nevertheless ignore the Tax Court's findings that the agents had (R. 1121a) "made an extensive investigation from *all* available sources for the purpose of building up a net worth statement" (emphasis supplied) and that, more specifically (R. 1155a)—

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[17] The settled rule of this Court makes the concurrent findings below final, in the absence of exceptional error. *Comstock* v. *Group of Investors,* 335 U.S. 211, 214.

A search of the record does not disclose any testimony as to cash on hand at the opening of the taxable period belonging to members of the family other than the cash reserve claimed by William G. Lias. Petitioner testified that he was the only one of the family unit who handled the money. If the other members had cash at the beginning of the taxable period they still had it at the close of the period. Outside of the petitioner, the only member of the Lias family to testify in these proceedings was Gregory Manos, who did not testify that he had any cash on hand on January 1, 1942.

(2) More pointedly, however, the taxpayer had admitted that all assets held in the names of other members of his family group were his. (Pet. 33-34.) Both courts below agreed that the taxpayer had (Pet. 34) "so conducted his own affairs and those of the 'Lias Group' as to make it *impossible* to identify the individual ownership of assets" (emphasis supplied), and the Tax Court was (R. 1149a-1150a) "not persuaded that the petitioner did not create this confused situation deliberately and with purposeful design." In these circumstances, it was entirely appropriate to include all assets of the Lias Group in the net worth construction. Clearly, such action did not result in a consolidated family net worth in the sense that it reflected assets actually owned by the members of the Lias Group other than the taxpayer. In substance, as well as in intention, the resultant net worth was the taxpayer's alone. On this hypothesis, the Commissioner's act of offsetting the income reported during the taxable period by the other members of the Lias Group against the total net worth increases attributed in sub-

stance to the taxpayer is revealed as nothing more than a gratuitous benefit to the taxpayer, who should not be permitted to construe that act, out of context, as a means of transmuting the essence of the net worth computation.

2. The decision below is not, as the taxpayer contends (Pet. 24-27), in conflict with the decisions of other Courts of Appeals on the question of the proof required to establish fraud. The proof of fraud in this case does not depend upon the persistent understatement of income alone, substantial though it was. Here, there was not only "evidence of a consistent pattern of under reporting large amounts of income" (*Holland* v. *United States,* 348 U.S. at 139), but also of acts constituting "conduct, the likely effect of which would be to mislead or to conceal" (*Spies* v. *United States,* 317 U.S. 492, 499). For example, among other things, the taxpayer did not keep any personal books or records, inordinately used large amounts of cash, concealed assets and covered up sources of income, gave conflicting statements as to specific items in his returns, and caused a sham agreement to be entered into, falsifying the interests of members of his family group in various corporate enterprises. These were not "circumstances which at most create only suspicion" (*Goldberg* v. *Commissioner* (C.A. 5th), decided December 19, 1956 (1957 C.C.H., par. 9261)); on the contrary, they constituted "additional independent evidence from which fraudulent intent on the part of the taxpayer can properly be inferred" (*Kashat* v. *Commissioner,* 229 F. 2d 282, 285 (C.A. 6th)).

CONCLUSION

The decision of the court below is correct, there are no conflicting decisions, and further review is not warranted. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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APRIL 1957.

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period( fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 51. INDIVIDUAL RETURNS.

* * * * *

(b) [As amended by Sec. 303, Revenue Act of 1948, c. 168, 62 Stat. 110] *Husband and Wife.*—

(1) *In general.*—A husband and wife may make a single return jointly. Such a return may be made even though one of the spouses has neither gross income nor deductions. If a joint return is made the tax shall be computed on the aggregate income and the liability with respect to the tax shall be joint and several.

* * * * *

(26 U.S.C. 1952 ed., Sec. 51.)

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

(b) *To Determine Liability to Tax*—Whenever in the judgment of the Commissioner necessary he may require any person, by notice served upon him, to make a return, render under oath such statements, or keep such records, as the Commissioner deems sufficient to show whether or not such a person is liable to tax under this chapter.

* * * * *

(26 U.S.C. 1952 ed., Sec. 54.)

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * * *

(26 U.S.C. 1952 ed., Sec. 275.)

SEC. 276. SAME—EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

* * * * *

(26 U.S.C. 1952 ed., Sec. 276.)

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY

* * * * *

(b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612(d)(2).

(26 U.S.C. 1952 ed., Sec. 293.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.54-1. *Records and Income Tax Forms.*—Every person subject to the tax, * * * shall, for the purpose of enabling the Commissioner to determine the correct amount of income subject to the tax, keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of the gross income and the deductions, credits, and other matters required to be shown in any return under chapter 1. * * *

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